Commission of Inquiry
into
Residential Tenancies

A Review of the Literature Relevant to Rent Regulation

Eric B. Adams
Pearl Ing
John Pringle

Research Study No. 28

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Eric Adams
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John Pringle

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ERIC ADAMS, PEARL ING, JOHN PRINGLE: research staff of the Inquiry.

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CONTENTS

Page

Introduction 1

Section 1: The Market Effects of Rent Regulation ... 5

1.1 Introduction 5

1.2 Efficient Market Effects 5

1.2.1 Effects on Regulated Housing Stock 6
1.2.2 Market Responses to Disequilibrium ....
1.2.3 Effects on New Supply 22
1.2.4 Effects on Ownership Housing 31
1.2.5 Effects on Rents, Capital Values 32

1.3 Housing Market Characteristics and Imperfections 37

1.3.1 Internal Characteristics 39
1.3.2 External Factors 46
1.3.3 Operational Consequences 49

1.4 Summary 51

Notes to Section 1 53

References to Section 1 58

Section 2: The Distributive Effects of Rent Regulation 71

2.1 Introduction 71

2.2 Evaluation of the Distributive Effects of Public Policy 71

2.3 Market Concepts and Distributive Effects 74

2.4 The Distribution of Direct Costs and Benefits Among All Households 77

2.4.1 Estimates of the Distribution of Rent Savings 78
2.4.2 Estimation Limitations 80

2.5 Distribution of Direct Benefits Among Tenants 82

2.6 Distribution of Direct Costs Among Landlords 85

2.7 Dual Markets, Excess Demand and Availability of Regulated Units 89

2.7.1 Rationing 90
2.7.2 Tenant Costs 92

2.8 Regulated Tenancies and Other Housing ... 96

2.9 Public Costs 98

2.10 Summary 99

Notes to Section 2 102

References to Section 2 104

Section 3: Rental Housing Affordability 109

3.1 Introduction 109

3.2 Historical Perspective 109

3.3 Traditional Indicators of Housing Problems 112

3.3.1 Physical Inadequacy 112
3.3.2 Crowding 115
3.3.3 Rent-to-Income Ratios 117

3.4 Alternative Measurement Approaches 124

3.4.1 Rent-to-Income Scales 125
3.4.2 The Core Need Approach 126
3.4.3 The Budget Approach 128
3.4.4 Ability-to-Afford Measures 131

3.5 Specific Groups in Need 132

3.5.1 Low-Income Households 133
3.5.2 The Elderly 135
3.5.3 Single-Parent Households 139

3.6 Income or Housing Problems 139

3.7 Summary 143

Appendix 3A: Table of Affordability Measures 146

Notes to Section 3 149

References to Section 3 151

Section 4: Housing Policy, Programs and Submarkets 156

4.1 Introduction 156

4.2 Historical Development of Canadian Housing Policy 156

4.3 Public Housing 168

4.4 Non-Profit and Cooperative Housing Programs 173

4.5 Housing Allowances 181

4.6 Evaluation of Housing Programs 190

4.7 Problems of Housing Submarkets 194

4.8 Summary 197

Notes to Section 4 199

References to Section 4 202

Section 5: Security of Tenure 206

5.1 Recent Developments 206

5.2 Complementarity of Security of Tenure and Rent Regulation 212

5.3 Tenant Concerns 219

5.3.1 Economic Costs 219
5.3.2 Tenants' Bargaining Position 221
5.3.3 Alternative Policies 223

5.4 Summary 226

Notes to Section 5 228

References to Section 5 230

Section 6: The Political Economy of Rent Regulation 232

6.1 Introduction 232

6.2 Recent Theories of Regulation 232

6.3 Political Economy of Rent Regulation in the United States 235

6.4 Evolution of Rent Regulation in Ontario 245

6.5 A Review of Rent Seeking Literature 264
6.6 Summary 273
Notes to Section 6 274
References to Section 6 277
Bibliography 279

INTRODUCTION

The recent resurgence of rent regulations has been parallelled by a dramatic increase in the volume of related conceptual and empirical literature. The purpose of this review is to present an objective summary of the literature pertaining to rent regulation as of 1984. It was originally written in 1983 to serve as background material for the Inquiry's work. More recent literature, in particular, the Phase II studies commissioned by the Inquiry, are not covered by this review.

A broad range of issues, arguments and sources are outlined to familiarize the reader with the relevant literature. As such, it includes reviews of articles in both journals and the larger volume of other published and unpublished literature. The review does not attempt to summarize in entirety, each and every paper which is cited. Rather, we focus on principal arguments and issues, with additional references cited, either in support of or in contrast to those reviewed. It is hoped that the principal arguments concerning rent regulation are adequately discussed; any gaps are unintentional.

In this review, our efforts are focussed primarily on the impact of contemporary rent regulations. Typically, these enable allowable increases with or without approval of some form of cost pass through. The cost pass through provisions may or may not contain return on investment features.

The review consists of six sections:

1. Market Effects of Rent Regulation
2. Distributive Effects of Rent Regulation
3. Rental Housing Affordability
4. Housing Policy, Programs and Submarkets
5. Security of Tenure
6. Political Economy of Rent Regulation.

While each section is written to stand on its own, some cross-referencing is employed to place specific arguments within broader contexts. Each section is accompanied by its own reference list. A bibliography, incorporating all topics covered in the literature review, is provided at the end of the paper.

The first two sections address many economic issues pertaining to rent regulation. Section 1 explores the commonly cited effects of rent regulation on the demand for, and supply of, rental accommodation. Included are effects on the quality and level of housing services, conversions, abandonment, demolitions, new supply, rents and capital values, mobility and housing consumption efficiencies. This section differentiates between two views of the housing market. The first assumes the housing market is competitive; the second examines housing market characteristics, imperfections and operational consequences.

Section 2 focusses on the distributive impact of rent regulation. General policy considerations are outlined as these have provided researchers with a framework for the analysis of the distributive effects of government policies. Conceptual issues arising from the perceived nature and operation of rental markets are addressed in terms of the effects of rent regulation in distributing resultant costs and benefits.

This section also looks at the empirical estimates of possible rent reductions in Ontario and how these reductions may have been distributed between and among both landlords and tenants. Indirect effects such as reduced tenant mobility are briefly reviewed. Finally, estimates of administrative costs and possible revenue losses through tax reductions are examined.

Sections 3 and 4 provide a detailed background to the housing market in terms of housing affordability and government programs designed to alleviate hardship among low and moderate income groups. Section 3 concentrates on the methods and empirical findings of various affordability studies. Traditional indicators of affordability problems are presented along with criticisms voiced in the literature. Alternate approaches, designed to overcome the limitations of the traditional methods, are described and estimates are compared. This section also outlines the debate between housing problems and income problems as set out in the literature.

The intent of Section 4 is to provide insight into government activity in the housing market. A major part of this section focusses on the design and operation of past and existing housing programs other than rent regulation. Current housing programs in Ontario are critically evaluated on the basis of how well the housing needs and demands of low and moderate income households are served. As well, housing allowances, regarded as a viable alternative to current housing programs, are analysed.

Over the last decade, security of tenure has become an accepted doctrine in landlord-tenant law. Legislation enacting security of tenure has provided some protection to tenants in terms of a certain degree of control and security over their housing. A general belief exists that security of tenure and rent regulation must jointly be in place if either legislation is to be effective. Section 5 examines and summarizes issues related to the current structure and potential impacts of security of tenure. In particular, this section examines how security of tenure legislation has affected landlord-tenant relations and the balance of property rights between landlords and tenants.

Section 6 amalgamates various pieces of literature dealing with the political-economic effects of rent regulation. This section briefly reviews the development of recent economic and political-economic theories of regulation and applies these theories to the rental housing sector. The relevance of several of these theories is examined in light of rent regulation experiences in Ontario and the United States.

SECTION 1: THE MARKET EFFECTS OF RENT REGULATION

1.1 Introduction

This section of the literature review focusses on the effects of rent regulation in the housing market. For purposes of the review, the literature is classified according to assumptions about the competitiveness of the housing market. The majority of the literature assumes that the housing market suffers from no major market imperfections in the absence of regulation. That literature is examined in Subsection 1.2. Subsection 1.3 reviews the literature which examines housing market characteristics, imperfections and their operational consequences. The literature reviewed in both of these sections deals largely with the efficiency effects of rent regulation. Equity effects and affordability issues are dealt with in Sections 2 and 3 respectively.

1.2 Efficient Market Effects

The majority of the housing literature analyses the market under the assumption that there are no serious market failures in the absence of rent regulation. This assumption implies that the unregulated market price reflects landlords' costs, including the opportunity cost of their capital, and there is little or no opportunity for landlords to charge rents which would result in returns in excess of the opportunity costs. Furthermore, in the absence of market failure, the market determined price maximizes economic efficiency.(1)

1.2.1 Effects on Regulated Housing Stock

A number of studies (Arnott, 1981; Frankena, 1975; Kain, 1974; Rothenberg, 1977; Smith and Tomlinson, 1981) conclude that landlords who either anticipate or experience a return under regulation that is less than a market (competitive) return will seek to reduce the supply of housing services.(2) According to Kain:

> It is a fundamental characteristic of competitive markets and industries that profits or payments to factors in excess of these amounts [competitive return] will be competed away by increases in supply, either by existing or new firms. Similarly, profits and payments to factors below this "competitive" level will in the course of time be increased to the competitive level by reductions in supply brought about through the withdrawal of capital and entrepreneurship from the industry. (1974, p. 4)

Potentially, landlords may reduce the supply of housing services in a number of ways: reductions in quality and services,(3) tenure conversions, abandonment and demolition, and withholding investment in the construction of new rental buildings. Close inspection of these analyses, however, indicates that the effects of rent regulation on supply are uncertain; they depend critically on assumptions concerning the form of regulation and accompanying legislation, market conditions, and supply elasticities and maintenance technologies. Together these factors determine the relationship between the regulated rents and market rents for a particular area and a particular time.

Changes in Quality, Services

In the standard analysis of price regulation, the unit price of the commodity exchanged is regulated. A system which regulates the price per unit housing service of all apartment units is consistent with the standard textbook example of a price ceiling beneath a market equilibrium (for example, Samuelson and Scott, 1966, pp. 456-457). In that model of regulation, if demand is elastic, the quantity of housing services demanded will increase relative to the equilibrium quantity. If supply is elastic, then the quantity supplied will decrease. A reduction in the supply of housing services could take the form of tenure conversion, demolition and abandonment of rental units. If it is the price per unit of housing services that is regulated, the supply reduction would not take the form of reduced services(4) provided to tenants (such as social or recreational facilities being closed) since the price that the landlord could charge would be reduced thus offsetting the cost saving. Since price regulation increases the quantity demanded and decreases the quantity supplied (and even if the supply is perfectly inelastic; hence, quantity supplied will not change), there will be excess demand and non-price rationing.

In practice, rent regulation constrains the rent of an apartment unit, not a hypothetical unit of housing service. Frankena (1975) and Smith and Tomlinson (1981) contend that although there may be provisions for rent reductions if the level of maintenance or services declines, such reductions are hard to identify and measure. Assuming the regulated rent is set below the competitive level, landlords would have an incentive to reduce the supply of housing services per apartment unit in order to reduce costs. By cutting service levels, landlords realize an effective price increase per unit housing service (Arnott, 1981; Frankena, 1975; Kiefer, 1980; Moorhouse, 1972). Owners would save on maintenance (and other discretionary expenditures) without suffering a decline in rental income. Unless services are cut enough to eliminate the gap between the regulated and competitive rent levels, reducing services will not create vacancy losses for landlords (Alexis and Fitzpatrick, 1983; Olsen, 1972). Rent regulation, as described by Rothenberg:

> Gives each owner of an existing unit at any quality level inducement to convert the unit downward in quality while retaining its old nominal price -- thereby raising real prices throughout. (1977, p. 89)

Arnott (1981) and Kiefer (1980) argue that in a competitive market with a price ceiling, rent cannot exceed the market-clearing rent. According to Arnott (1981), Frankena (1975) and Kiefer (1980), landlords would adjust quality so that regulated rents in units (whose quality has been reduced) would be comparable to market rents in the absence of regulation. Arnott says:

> ....the landlord will choose to run down the building at such a speed that the controlled rent will just equal the market-clearing rent. (1981, p. 52)

In contrast to the predictions of excess demand and non-price rationing when rent regulation is a restraint on a unit of housing service, this form of regulation suggests excess demand and non-price rationing may not arise if a short-run equilibrium is re-established by a reduction in the quality of the regulated stock (Arnott, 1981; Frankena, 1975).

If initial reductions in quality and services are sufficient to eliminate excess demand, regulation is non-binding as the regulated rent equals the market (competitive) rent (Arnott, 1981). Landlords reduce the flow of services but receive a rent per unit housing service equivalent to competitive levels. Tenants pay a lower nominal rent for their apartment but pay a higher effective rent per unit housing service than in the absence of regulation (Arnott, 1981; Frankena, 1975; Rothenberg, 1977).

Arnott (1981) suggests that quality reductions to market levels are one possibility for landlords under guideline regulations. Alexis and Fitzpatrick (1983), Kiefer (1980), Moorhouse (1972) and Rothenberg (1977) believe this effect is possible with cost pass through regulations that allow rent increases for quality improvements or operating cost increases but without compensating rent reductions for quality and operating cost reductions.

A second argument concerning quality relates to the effect of regulation on capital or market values. The market value of a building is equal to the present discounted value of expected net revenues. The expectation that future net revenues will be less under regulation reduces the market value of the building.(5) Eckert (1983), Moorhouse (1972) and Smith and Tomlinson (1981) argue that regulation with cost pass through provisions restricts nominal net revenues to the levels when regulations are initiated. In an inflationary environment, real net revenues and market values decline. According to Moorhouse (1972) when regulation is a restraint on the rent of an apartment, landlords will adjust real rents by adjusting quality;(6) in particular they raise real rents by reducing maintenance expenditures. He says:

> To the extent an entrepreneur fully anticipates a lower new revenue stream from a controlled building, he will find it optimal to adjust his maintenance to a lower level and shorten the operating life of the building.... Under rent control then, dynamic equilibrium is preserved by adjustments in maintenance and the economic life of a structure. (p. 100)

Smith and Tomlinson argue:

> Since investors as a group cannot immediately reduce their holdings, except in the sense that the value of these holdings declines, they have an incentive to gradually reduce the real value of their investments by planned deterioration. Lower expenditures for repairs and maintenance accomplishes this by trading reduced capital values for increased net cash flows. (1981, pp. 105-106)

Alexis and Fitzpatrick (1983), Arnott (1981) and Rothenberg (1977) suggest that beyond the initial incentive to reduce quality, the net effect depends on the quality distribution of regulated units, demand, regulation induced changes in market rents and related rent differentials, and new construction occurring at different quality levels (See, for example Arnott, pp. 53-54). Under the assumption that landlords are able to reduce the supply of services whenever regulated rents are less than market rents, this approach has been used to predict that the existing stock of regulated units will eventually be eliminated as successive quality reductions shorten the economic life of the building (Arnott, 1981; Frankena, 1975; Fallis and Smith, 1984a).

These studies identify an initial incentive to reduce the quality, services and, hence, supply of regulated units. However, there are other significant qualifications (beyond those noted above) to this conclusion in these same articles. Kain (1974) suggests the effects of regulation depend, in part, on the elasticities of supply. He reviews the polar cases of perfectly inelastic supply and perfectly elastic supply. In the former, rent regulation which holds price down and reduces expected net income leads to a reduction in capital values and excess demand. In the latter, landlords would either reduce the quantity of housing services to the level consistent with a competitive return at the controlled price or effect conversions or shift their capital and entrepreneurial skills to other industries. Kain believes that the real world lies somewhere in between. On the one hand, housing capital does depreciate and:

> Under certain circumstances this depreciation can be quite rapid. Landlords have some ability to reduce services in the short run

> and this scope increases rapidly with time. (1974, p. 10)

On the other hand:

> Landlords may have only limited scope to reduce housing services in the short run; there are certain legal constraints on their actions under rent control, but more important they may have to depreciate their capital in order to reduce their services significantly. Moreover, some maintenance outlays may be rational even under rent control as long as a positive, perhaps even a future competitive return to capital and other immobile factors is expected. (p. 9)

Similarly, Frankena (1975) indicates that it may take a long time to re-establish a short run equilibrium position:

> In the shorter period of time relevant to some issues in rent control, there may be narrow limits on the amount by which a profit-maximizing firm would reduce the flow of housing services from a dwelling unit. Rapid deterioration may not represent an optimal path to a lower quality level... As a result in the very short run the firm might supply housing services at a price lower than that which would clear the market under rent control, and there could be excess demand for housing services. (pp. 306-307)

Arnott (1981) suggests that, depending on the 'structure' of rents and maintenance technology, landlords may not be able to reduce the quality to the point where regulated rents are at competitive levels. In this case guideline regulations are considered to be binding. Rents are less than market (competitive) rents; hence, there will be excess demand. Quality may be similar to competitive levels in the absence of regulation. Landlords incur a capital loss.(7)

Frankena (1975) thinks that the effect on maintenance depends on the actual regulatory mechanisms: there may be effective constraints on the level of housing services, regulations may apply to only part of the rental market, or regulations may be avoided.

Arnott (1981) indicates that the effects of cost pass through regulations on quality are uncertain. They depend on market conditions and the quality of the building when regulations are initiated. Maintenance expenditures may increase or fall. Moreover, regulations that enable landlords to choose between accepting a specified (guideline) increase or applying for rent review for a higher increase based on increased costs yield a range of possible landlord responses. The effects on quality of the regulated stock are uncertain; it may remain constant, it may fall below what it would have been in the absence of regulation.

Theoretical analyses of landlord maintenance decisions (Arnott, 1981; Kiefer, 1980; Moorhouse, 1972; Rothenberg, 1977 and Sweeney, 1974a, 1974b) indicate that in the absence of regulation landlords will undertake maintenance to the point at which the last dollar spent increases the building value by one dollar. Arnott, prior to developing his model and differentiating between forms of regulation, argues that:

> All known forms of rent control, however, result in each dollar of maintenance increasing the value of the property by less than it would have increased without controls. (1981, p. 21)

He describes an example where regulated rents are held substantially beneath market-clearing levels:

> Because there is considerable excess demand, the landlord can rent his apartment even if he spends nothing on maintenance. The profit-maximizing expenditure in this example may be zero. (p. 21)

Depending on market conditions, it is also possible that a landlord would seek to maintain or improve the quality of a unit (as his later analysis of cost pass through regulations indicates). According to Rothenberg (1977) quality changes in the regulated stock may alter the supply at various quality levels. A profit-maximizing response may lead to quality improvements, higher rents through rent review and higher capital values (Slack and Amborski, 1984). Whether the increase in property value would be less than in the absence of regulation is an empirical question.(8)

There appears to be little empirical evidence to support the prediction that landlords will reduce the quality of the regulated stock in order to equate the market-clearing rent to the regulated rent. One common statistical approach compares the percentages of rent (gross or net) spent on maintenance in regulated and non regulated buildings (or the trend within regulated buildings alone) (Eckert, 1983; Lett, 1976; Rydell et al., 1981 and Sternlieb et al., 1974, 1975). For example, Lett in an analysis of the Boston market, found that the:

> Analysis (Exhibit 5-7) tended to confirm our working hypothesis of a decline in maintenance

> in controlled buildings; subject to the limitations of size of sample, this trend seems to be relatively unaffected by the scale of the structure. (1976, p. 132)

Still, without further qualifications, it is not clear from this type of statistic that maintenance has declined. The decrease recorded in the high-rise category from 15.2 per cent to 14.4 per cent may be due to increased maintenance efficiency (Ontario-MOMAH, 1982a, p. 45) rather than a reduction in maintenance services.(9) There are apparent increases in maintenance expenditures in the regulated sector in the 'other' building and 'number of units' categories. On the other hand, they may be constant but inflated by lower revenue growth (Gilderbloom, 1980). A recent analysis found the latter to be the case for a small sample of properties in Ontario (Campbell Sharp, 1984).

Other studies show the rent dollar broken down into various expense categories (for example, Eckert, 1983 in Brookline, Massachusetts; and Rydell et al., 1981 in Los Angeles). Rydell found a slight reduction in 'cosmetic' maintenance (painting and groundskeeping) but an increase in expenditures on repairs. Eckert, utilizing audited income and expense data from the local regulatory board for various building size groups, determined that in some building size groups painting and decorating, and maintenance and repair had decreased while in others it had increased. In all data sets, capital improvements increased.(10) Eckert concludes:

> All of the data sets taken together would lead us to conclude that landlords are spending

> about as much for repairs and maintenance as a percentage of the rent after six years of rent control as they were in the year immediately preceding Rent Control. (p. 56)

He believes that rather than allowing the building to depreciate which would shorten the economic life of the building, as argued by Moorhouse (1972), landlords would seek to convert their property to ownership status where possible, or file for property tax abatements for reduced market value.

These studies along with the previously noted qualifications in the theoretical literature suggest that 'cosmetic' maintenance expenditures may be reduced but that the basic structural quality is maintained. Steele and Miron (1984, footnote 40) make this point concerning Ontario. This may indicate that landlords do not reduce the quality and level of services to the point where the regulated rent equals the competitive rent (and excess demand is eliminated).(11)

A second method employed to analyse quality levels and changes in those levels is based on surveys of tenant and landlord perceptions. Surveys endeavour to control for the inherent subjectivity of individual responses by focussing on output measures of maintenance such as the incidence of elevator breakdowns, or frequency of repairs and often utilize multiple perspective approaches (landlord, tenant, observer) (Ontario-MOMAH, 1982a). A recent study of the Toronto rental market suggests that tenant (in a one year period) and landlord (one and five year periods) responses indicated no change in the level of maintenance and concluded that:

> In all, the evidence on changes in maintenance does not support the view that conditions have become noticeably worse. (Ontario-MOMAH, 1982a, p. 54)

However, this may be too short a period to determine the effect on maintenance. On the one hand, Arnott (1981), Eckert (1983) and Kain (1974) suggest that landlords may not reduce maintenance and quality in the short run if regulations are assumed to be temporary. Moreover, according to Braid (1981, p. 299), the quality adjustment models such as Arnott (1981) and Rothenberg (1977), are indicative of medium and long term effects. On the other hand, the various models suggest that if maintenance has not been affected significantly, either rent regulation is having little effect or there should be excess demand (due, either to effective regulation or to restraints imposed by the maintenance technology) (Arnott, 1981; Slack and Amborski, 1984).

Tenure Conversions, Abandonment and Demolition

Alternatively, or in addition to a reduction in services, landlords may have the opportunity to change the tenure status of rental units to ownership thereby avoiding possible capital losses (Arnott, 1981; Eckert, 1983; Kain, 1974; Rea and Gupta, 1982). According to Arnott:

> If there are no regulations restricting conversion, then rental housing will be converted to owner-occupancy status whenever

> its market value when rented falls below its value when owner-occupied. (1981, p. 58)

Rothenberg suggests:

> The lesser lifetime rate of return expected from a rent-controlled existence in the rental market can be by-passed by selling the property for ownership, since the forces leading to excess demand in the former probably operate in the latter as well, but without the profit-dampening operation of rent control. (1977, p. 91)

Smith and Tomlinson argue:

> The declines in the real value of rental dwellings, and especially the declines in their value relative to non-rental housing, provide incentive to convert rental to ownership and thereby further diminish the rental housing stock. (1981, pp. 100-101)

The opportunity to convert to ownership reduces the incentive to reduce quality in the regulated sector particularly at high quality and rent levels but accentuates the loss of rental housing units (Arnott, 1981; Rothenberg, 1977).(14)

The existence of prohibitions against condominium conversions in many jurisdictions (City of Toronto, for example) may preclude empirical determination of a causal relationship.

Smith and Tomlinson (1981) note, however, that 10,306 designated rental units under construction in 1975 and 1976 at the time regulations were initiated in Ontario but exempt from prohibitions against conversions to condominium status, were restructured and converted to condominium status. They suggest that these converted units represented approximately 50% of rental units under construction at the time regulations were implemented (p. 101). This may show a shifting of resources out of the rental sector due to uncertainties concerning potential coverage under rent regulation (in 1975) or concerns that regulations may be extended for units occupied after January 1, 1976. It may also be a method of evading regulation if condominiums are subsequently rented. Alternatively this may be a response to a strong ownership market.

This study also identifies the reconversion of joint owner-tenant occupied dwellings to single family dwellings in Toronto.(15) Such units are exempt from any prohibition against conversions in Ontario. A reduction of 3,261 units in this form had occurred in the City of Toronto between 1975-79. The authors suggest that although:

> There are numerous causes for the reconversion process, rent control, which has reduced the income potential of these properties, is a contributing factor. (1981, p. 101)(16)

One community in Massachusetts which did not restrict conversions recorded 2,000 conversions over the period 1971-1979 representing about 20 per cent of the regulated sector (Eckert, 1983, pp. 52-53). This was attributed to rent regulation. However, the literature identifies a variety of factors, which may influence the relative profitability between the rental and ownership markets and hence the incentive to convert.

An extensive study of rental conversion to condominiums in the United States (U.S.-HUD, 1980) suggests that, independent of rent regulation, there has been a decline in the profitability of rental housing which may have led to an increase in condominium conversions. The report argues that a relative decline compared to the ownership market and to the condominium sector in particular, has occurred because of increased profitability within this sector reflecting a growing demand for ownership (with condominiums a more affordable option than single family houses) largely produced by inflation and tax advantages (see Diamond, 1978; Hendershott, 1980, 1982; Hendershott and Hu, 1981; Rosen, 1979; Rosen and Rosen, 1980; Schwab, 1982; Smith, 1983; Weiss, 1978 and Weicher et al., 1981). According to the HUD report:

> The profit made by rental property owners on sales to converter/developers is the proximate cause of conversions. The most direct cause is the availability of households willing to buy from the converter/developer. Market values of rental properties have increased dramatically due to the conversion option, and property owners have been receiving purchase prices far in excess of the resale values of these properties as rentals. There is evidence that in some, and perhaps all, markets, the difference in market values is also a function of decreasing operating margins. There is even stronger evidence that the difference reflects a shifting of some middle-income housing demand from rental to ownership. (U.S.-HUD, 1980, Chapter V, p. 31)

This study includes several jurisdictions which had enacted some form of rent regulation (Boston, Los Angeles, Newark, New York City, San Francisco, San Jose and Washington, D.C. SMSA.). It was noted that New York, Boston and Washington, D.C. were among those with the highest number of conversions. However, the largest number was in Chicago where rent regulation had not been enacted. Denver and Houston also do not have rent regulation, yet have experienced high conversion volumes. Conversions were associated with:

> Healthy, perhaps tightening rental markets characterized by strong demand for home ownership and by higher-than-average rent levels. (Ibid., p. 15)

On the effects of rent regulation, the report concludes that they:

> Are not necessary conditions or leading causes of condominium and cooperative conversions, if for no other reason than that so few of the jurisdictions with conversions have enacted such measures. (Ibid., p. 17).

If the economic return from rental housing falls below the value of the site and landlords do not have the opportunity to convert, they may abandon or demolish their properties (Arnott, 1981; Kiefer, 1980; Moorhouse, 1972). Cheung (1975) and Thurow (1980) suggest that if new construction is exempt, landlords may allow existing units to deteriorate in order to demolish and then construct new, exempt buildings.

There appears to be little empirical evidence to support this claim.(17) Rather, the literature tends to suggest the incidence of abandonment/demolition is part of a dynamic social and economic process related to urban growth and changing land values.

A study of five Canadian cities by Skaburskis (1979) indicates that growth rates and development pressure are the main causes of demolitions in Vancouver, Calgary and Toronto where older dwellings in the inner city have been replaced with duplexes or apartment buildings depending on the zoning ordinances. Code enforcement (fire and health, property standards or minimum maintenance by-laws, building codes and demolition control by-laws) was said to affect:

> The location and timing of demolitions rather than the overall long term rate of stock loss. If code enforcement did not clear the sites, the pressure for land-use intensification would. (1979, Working Paper 3, p. 22)

Abandonments were prevalent in Montreal and St. John but occurred less frequently in the other cities. Skaburskis suggests that market conditions, principally a relative decline in the demand for rental units either from an over-supply of new units or a decrease in investor confidence or interest, are the underlying causes of abandonments. Thus, the rate of increase in abandonments is attributed to a combination of factors. These also include, according to Skaburskis: redlining (a practice whereby financial institutions and insurance companies delineate portions of urban centres as 'undesirable' or high risk areas; financing and insurance costs are higher resulting in reduced investment opportunities), code enforcement, housing policies such as rehabilitation assistance, lack of knowledge concerning rehabilitation and lack of a 'rehabilitation industry' (in some areas), and neighbourhood effects.

1.2.2 Market Responses to Disequilibrium

The literature identifies a number of possible responses when markets do not clear. Under universal coverage (all units) regulations, non-price rationing of excess demand will occur. When there is an exempt sector, two possibilities arise: non-price rationing in the regulated sector and spillover excess demand into the exempt sector. In the latter case, tenants unable to find accommodation in the regulated sector have no alternative but to seek accommodation in the exempt sector.

Various forms of non-price rationing such as queuing, discrimination and black market operations (bribes, key money) have been identified as likely consequences of a strong demand for regulated units (Arnott, 1981; Cheung, 1975, 1979; Frankena, 1975; Howenstine, 1977; Moorhouse, 1972). There may be new contractual arrangements governing the exchange of housing services such as shifting of maintenance responsibilities to tenants (Frankena, 1975; Moorhouse, 1972). Rent regulation would not be binding if a tenant seeking accommodation in the regulated sector makes a side payment (equal to the difference between the regulated rent and competitive rent, less any increase in the cost of making an exchange) with either the landlord or sitting tenant.

Cheung (1974) suggests that when the potential income benefit (to tenants) or loss (to landlords) is not assigned by the legal framework exclusively to an individual, there is an incentive for those involved to enter into new contracts governing the exchange of housing services that maximize the benefits or minimize the losses. Further, contracting parties will try to minimize any increase in negotiation or contract costs (over those in the absence of regulation). These aspects are developed further in Section 6 of this paper and Hartle (1984).

Tenants unable to find accommodation in the regulated sector will seek accommodation in the exempt sector. According to Smith and Tomlinson:

> Rents will rise in the uncontrolled sector until the excess demand is rationed out... (1981, p. 104)

A dual market may result in which rents for a standardized unit of housing service in the exempt sector are higher than regulated rents and likely higher, in the short run, than market rents in the absence of regulation (Fallis and Smith, 1984a, 1984b; Marks, 1982, Smith and Tomlinson, 1981). Fallis and Smith (1984a) suggest that when the regulated stock is allocated to tenants occupying it at the time regulations are initiated, shifts in demand arising from in-migration or increases in income will be accommodated in the exempt sector. They indicate there may be conditions in which rents in the exempt sector are less than rents in the absence of regulation (depending on income and housing preferences), but argue that they will probably be higher. In either case, rents in the exempt sector are higher than regulated rents. Fallis and Smith (1984a) in one test of their model (1978-80, in Los Angeles) indicated that:

> After two years, controlled rents had risen an average of 13.7 per cent and uncontrolled

> rents had risen an average of 46.2 per cent. These compare with the forecast increase of 23.9 per cent. Consequently, the data confirm that rent controls effectively constrained rents on controlled units, but enabled larger rent increases on decontrolled units than would have occurred in the absence of rent controls. (1984a, p. 199)(12)

Fallis and Smith (1984b) in a study of the Toronto market calculated that rents, in 1982, in the exempt sector were between 8.1 and 10.3 per cent higher than they would have been in the absence of rent regulation and 24 per cent higher than regulated rents once quality differences were taken into account.

Some literature suggests that housing consumption inefficiencies are likely to occur when vacancy rates are low, as increased search costs or reduced prospects of securing accommodation in the regulated sector or both, reduce household and labour mobility (Arnott, 1981; Ault, 1981; Clark and Heskin, 1982; Hayek, 1972; Hazlett, 1982; Rothenberg, 1977).

Rothenberg suggests that with an exempt sector:

> The controlled, lower-priced units are highly preferred. They come to have extremely low vacancy rates, large waiting lists and low turnover, present tenants cannot expect to obtain so good a bargain in the uncontrolled portion of the market, and so may remain in these units long after their desired type of housing has changed markedly. The match of tenant's characteristics and housing characteristics can come to decline appreciably as household characteristics change over time while households feel frozen to controlled units. (1977, p. 90)

With respect to housing consumption inefficiency, DeSalvo, in his study on New York City, concludes:

> Tenants of controlled housing consume neither substantially more nor substantially less housing than similar families in uncontrolled housing: the principal difference is that controlled tenants pay considerably less than the market value for the property they consume. (1971, p. 227)

Weinberg, Friedman and Mayo (1981) in an analysis of the effects of rent rebates on housing demand by low-income renters conclude:

> The economics of the housing demand of low-income households is such that relatively large changes in traditional economic variables such as prices and incomes [as a consequence of rent rebates] result in relatively small changes in equilibrium housing demand. (p. 345)

This suggests that a relative price reduction resulting from rent regulation may not lead to increased housing consumption but rather increased non-housing consumption.

Clark and Heskin (1982) provide evidence that tenant mobility in Los Angeles was reduced from 38 per cent in 1977 to 24 per cent in 1979-80. One reason for a reduction in mobility is that regulation in Los Angeles allows for vacancy decontrol. Moreover, Clark and Heskin note that there are substantial tenure discounts even in the absence of regulation. Tenure discounts may reflect potential vacancy losses, market costs and inducements to retain tenants with desirable characteristics. Upon vacancy decontrol, landlords adjust rents fully for the tenure discount in the absence of regulation, for any tenure discount attributable to regulation and perhaps an additional increase.(13) They argue that a low vacancy rate, compounded by a low mobility rate makes:

> Moving exceptionally difficult both for those who choose to move and those who are forced by circumstances. The cost of search is likely to increase and the additional loss of tenure discount suggests that the pressure to stay, rather than move, is sufficiently strong for all but the relatively wealthy. (p. 112)

In Ontario, according to Blatt (1982, p. 34):

> The Rental Market Survey done annually by the Ministry of Municipal Affairs and Housing has indicated that mobility rates among renter households, in the seven cities covered by the survey, has remained constant between 1978 and 1980. In both of these surveys the mobility rate ranged between about 33% and about 49%. Although vacancy rates are low, mobility rates have remained at a high level. (See also Ontario-MOMAH, 1982a, Table 5.4)

1.2.3 Effects on New Supply

The effects on new supply depend on whether or not potential developers anticipate that they will be subject to rent regulation (Arnott, 1981; Rothenberg, 1977). Even if rent regulation does not apply to new supply initially, there may be some risk that regulations will be extended creating uncertainty about future profitability (Ault, 1981; Olsen, 1972; Rothenberg, 1977). The possibility of capital losses subsequent to regulations being extended may require a risk premium in order to justify new construction (Fallis, 1984; Kain, 1974; Olsen, 1972; Smith and Tomlinson, 1981). Fallis (1984) says the more suppliers believe that regulations may be extended:

> The higher the initial rent needed to justify new construction. The risk of subsequent control means that a higher rate of return is needed to attract capital into the industry. (p. 19)

Similarly, Smith and Tomlinson argue:

> By creating the expectation that the capital appreciation component might be lost or reduced by the extension of controls, rent control necessitates a much larger net cash flow and hence much higher rent to justify new construction. (1981, p. 97)

Rothenberg (1977) suggests that in the absence of this risk premium, there would be less new construction at every price level and a higher (than in the absence of uncertainty) market rent.

The risk premium effect may result in a higher long run rent (supply price) than in the absence of regulation (Fallis, 1984; Olsen, 1972). This is an empirical question that has not received attention in the literature. The risk factor, however, may imply that the real effects on new supply lie somewhere between the two cases discussed in the following sections.

New Units Not Subject to Regulation

The literature is somewhat ambiguous as to the effects of rent regulation on new supply if new supply is exempt from regulation; it identifies factors working in both directions. On the one hand, Fallis and Smith (1984a, 1984b), Marks (1982) and Smith and Tomlinson (1981) reason that rent regulation will create spill-over demand into the exempt sector (and new units) which will initially increase the market price for new rental units of comparable quality to those in the regulated sector. Assuming there is no risk that rent regulation will hold down future rent increases for new units, the result should be increased construction of new units. Furthermore, if landlords reduce the quality and flow of services leading to a more rapid deterioration of the regulated stock, market rents would increase (as supply decreases) and stimulate new supply (Alexis and Fitzpatrick, 1983; Arnott, 1981; Rothenberg, 1977). On the other hand, Clayton and Lampert (1982a, 1982b), for example, argue that tenants may become conditioned to the lower regulated rents, may perceive rents in the exempt sector to be excessive and adjust lifestyles and preferences in order to avoid paying higher rents (1982b, p. 9). This demonstration effect may cause tenants to resist the market prices of new units even if those tenants are unable to gain possession of a regulated unit (Clayton Research Associates, 1984a; Rothenberg, 1977).

New Units Subject to Regulation

When new units are subject to regulation, Kain (1974) contends that there would be no new construction in the regulated sector:

> As long as the expected annual return on new capital and entrepreneurship remained below the return in competitive industries... (1974, p. 8)

It follows from the analyses of Arnott (1981), Alexis and Fitzpatrick (1983), and Rothenberg (1977) that as demand increases and supply decreases (increasing excess demand) the market entry price for new units will eventually rise to a level which will justify new construction. In this case, Alexis and Fitzpatrick (1983) argue that new supply may not be discouraged even if price increases after entry are restricted. If entry prices themselves are restricted to a level comparable to the regulated sector, Frankena (1975) contends that it is possible that the price new units can command may never justify construction if the rent per unit housing service is regulated.

Studies that point to reduced levels of new, private sector construction under rent regulation, for example, Smith and Tomlinson (1981), face the empirical problem of controlling for other factors whose influence may overshadow that of rent regulation and prevent the determination of a causal relationship between rent regulation and the levels of new construction.(18) Arnott suggests:

> Controls may have had some effect on the volume of rental and owner-occupied housing construction. The volume of such construction has fallen significantly since the early 1970's, but this could be less because of rent control than because of decreased government assistance, higher interest rates, or the end of the baby boom's entrance into the housing market. (1981, p. 107)

The literature indicates that a number of factors may have contributed to recent declines in new rental construction. These include: demographics, tax changes which interact with inflationary influences on both the demand and supply sides to reduce the profitability of rental housing relative to home ownership (see also the text and citations concerning condominium conversions), cream-skimming of higher income tenants into ownership, historical lags in the rate of increase in rents, zoning and density restrictions, high construction, financing and inventory carrying costs in inflationary periods, and market failure in financial markets (Appelbaum, 1983; Cain and Scott, 1981; Clayton Research Associates, 1981, 1984a; Jones, 1983; Smith, 1983; Sternlieb and Hughes, 1980; Weicher et al., 1981). Moreover, as Arnott continues:

> Rent control may either stimulate or retard new housing construction, so that a fall in housing construction does not, by itself, suggest anything about the impact of rent control. (1981, p. 107)

1.2.4 Effects on Ownership Housing

A number of possible effects of rent regulation on the ownership market are identified. Arnott (1981) and Blatt (1982) suggest excess demand may spillover into the owner-occupied market, increasing prices. This, in turn, would stimulate new construction. Moreover, if investment in rental housing is reduced, tenants may be forced into the ownership market. Tenants may use savings gained through reduced rents to make downpayments on homes. On the other hand, demand for ownership housing may be reduced as tenants continue to seek bargain accommodation in the regulated sector.

Because these factors tend to be offsetting, Arnott and Blatt conclude that the overall effect is uncertain.

Empirical studies measuring these effects were not found. As Blatt states:

> In reality, there are so many other factors entering these equations that a whole study could be devoted to the purchase decision. Some of these factors are: the change in demographics, the increasing number of two earner households, the rise in interest rates and the expectations regarding continuing tenant protections. (1982, p. 38)

1.2.5 Effects on Rents, Capital Values

The efficiency effects of rent regulation likely depend, to a large degree, on the extent to which regulated rents are less than market (competitive) rents (Arnott, 1981; Mann and Veseth, 1983). It is important to note that market rents prior to regulation may have been above those associated with normal profits (Achtenberg, 1973; Kain, 1974) and regulation may reduce them to competitive levels (Kain, 1974).

Two approaches have been used to estimate the effect of regulation in Ontario on rent levels. The first forecasts rents in the absence of regulation as a function of vacancy rates and inflation or operating cost increases (Arnott, 1981, pp. 169-179; Fallis and Smith, 1984b; Smith and Tomlinson, 1981, p. 107).(19) Arnott estimates that, given a vacancy rate of 0.5 per cent in Toronto in 1981 and a 12.0 per cent rate of inflation, nominal rents would increase by between 6 and 15 per cent.(20)

Smith and Tomlinson estimate, assuming a 5.0 per cent equilibrium vacancy rate in Ontario in 1980, and given the 1980 vacancy rate of 1.5 per cent, that equilibrium rents would have been 7 to 8.75 per cent higher in the absence of regulation.

The second method compares rents in regulated units to non-regulated rents (Fallis and Smith, 1984b; Jazairi, 1983 and Miron and Cullingworth, 1983). Based on Canada Mortgage and Housing Corporation's rent survey data for buildings containing six or more units, Miron and Cullingworth report that in April, 1982, two-bedroom apartments in various Ontario cities had nominal monthly rent differences between regulated and exempt apartments as follows: Brantford $49, Hamilton $91, Kingston $33, Mississauga $125, Sarnia $64, Thunder Bay $70 and the City of Toronto $197. The data suggest that regulated rents were lower, particularly in Mississauga and Toronto. However, as the authors recognize, there may be quality differences between the two sectors. Controlling for these differences was the objective of the Jazairi (1983) and Fallis and Smith (1984b) studies.

Using a sample of 637 regulated and 500 non-regulated units in the Toronto Census Metropolitan Area in the fall of 1982, Jazairi determined that monthly average nominal regulated rents were about 27 per cent less than non-regulated rents. According to Jazairi:

> This nominal rent differential between the two markets is equal to the real rent differential only if the quality characteristics of the rental units within and between these two markets are identical. However, since the quality characteristics of the housing units whose nominal rent is being compared are different, then the real rent differential between these two markets must take into account the quality differentials of the dwelling units both within and between the two markets. (1983, p. 1)

Two other factors affect the comparison of relative rents. First, the market prices of housing attributes are not directly observable. Second, housing characteristics are highly interdependent (p. 6). Jazairi develops hedonic rent equations wherein rent is the sum of implicit prices of various quality and services characteristics such as number of rooms, age, access to subway, air conditioning, cable TV, parking and recreational facilities.(21) He utilizes various regression techniques to control for the interdependency factor. Once quality differences are taken into account, Jazairi finds that regulated rents in 1982 were between 9 and 14 per cent less than non-regulated rents in Toronto. He suggests that 9 per cent is a better estimate of the effect of rent regulation due to the interdependency factor (p. 26).

In a similar analysis, using different variables and a slightly different data set, Fallis and Smith (1984b) find that once quality differences are taken into account, regulated rents in 1982 were 20 per cent lower than rents in the exempt sector in Toronto. They estimate that equilibrium rents in the absence of regulation would be 90.6 per cent higher in 1982 than 1975. Comparing calculations of actual increases in regulated rents (69.6 per cent) and exempt rents (110.3 per cent), the authors conclude that regulated rents were 11 per cent lower and exempt rents 10.3 per cent higher than in the absence of rent regulation.

In view of the smaller nominal differences for jurisdictions outside of the Toronto area noted by Miron and Cullingworth, quality adjusted differentials in Ontario may be quite small and the Ontario average differential may be less than the Jazairi, and Fallis and Smith estimates for Toronto. According to Steele and Miron (1984) much of the 9 per cent difference calculated by Jazairi may be attributed to newness rather than exemption from regulation. Moreover, a variable reflecting length of tenure discounts is absent in both the Jazairi (1983), and Fallis and Smith (1984b) estimates. Weinberg, Friedman and Mayo (1981) and Merrill (1980) show this to be important in hedonic rent indices. Since regulated units are older than exempt units and because there are more regulated than non-regulated units, it is likely that more tenants in regulated units receive tenure discounts (Steele and Miron, 1984). In the absence of this variable, both the Jazairi (9 per cent) and Fallis and Smith (20 per cent) estimates may be too high. Fallis and Smith (1984a, 1984b), Marks (1982) and Smith and Tomlinson (1981) argue that rents in the exempt sector are likely to be higher under regulation than in the absence of regulation. Miron and Cullingworth suggest, therefore, that rents in the absence of regulation would likely be somewhere between regulated and non-regulated rents. They conclude that the impact of regulation on rents in Ontario may have been small. Ontario-MOMAH (1982a) estimates a rent reduction of 7.5 per cent for the province. Steele and Miron (1984) conclude for the province as a whole that the assumed 7.5 per cent discount is likely too large.(22)

There is limited evidence concerning the effect of rent regulation on capital values. Blatt (1982) and Smith and Tomlinson (1981) provide some evidence that in the City of Toronto and Metropolitan Toronto for the periods 1975-1979 (Blatt) and 1975-1980 (Smith and Tomlinson) the capital values of apartment units have declined in real terms and, in the latter study, relative to condominiums and all residential dwellings.(23) However, it is not clear from the information provided that all the rental buildings were subject to regulation. Jones (1983), Smith (1983), and Weicher et al. (1981), among others, have indicated that new rental construction has experienced reduced profitability relative to both ownership properties and other forms of investment. This would reduce rental property capital values relative to other sectors. Moreover, no distinction is made between buildings which have taken the guideline increase and those applying for rent review. If capital costs increase, permitted rent increases based on those cost increases may result in capital value increases.

There is little evidence of the effects of rent regulation on rental property profitability in Ontario. Ontario-MOMAH (1982) and Campbell Sharp (1984) both show that profitability (cash flow and return on capital measures) has declined since the early 1970s. Both studies were based on very small samples (Ontario-MOMAH, 68 buildings; Campbell Sharp, 8 buildings containing 934 units in total). Moreover, Ontario-MOMAH (1982a) was heavily weighted by buildings exempt from regulation (approximately 80 per cent were exempt). Campbell Sharp suggests that inflation was a factor leading to reduced profitability prior to 1975, while a combination of inflation and restrictions on rent increases were cited as factors for the post-1975 period. In both studies, the rate of return on the sample properties was less than that available on alternative investments. The Social Planning Council of Metropolitan Toronto (1983) provides some evidence that the return on investment (equity and capital) for the regulated properties in the Ontario-MOMAH (1982a) study was significantly higher than the exempt properties in 1980 and above, or comparable to, returns on other investments.

The analyses by Achtenberg (1973), Larmour (1975) and Weitzman (1983a) suggest that reduced capital values and slower growth in net rental income may be an intentional effect of rent regulation in order to reduce speculative appreciation in a strong market.(24) These aspects are reviewed below.

1.3 Housing Market Characteristics and Imperfections

That the rental market is perfectly competitive has been an explicit assumption in the analyses by Albon (1978), Frankena (1975), Moorhouse (1972) and Olsen (1972) and implicit in most other analyses of rent regulation. Further, implicitly or explicitly, rents in the absence of regulation are assumed to be long run competitive equilibrium rents. However, according to Rothenberg:

> Urban housing markets are not a good representative of the abstract general market of conventional economic theory. They possess a number of distinctive features that are at one and the same time, integral to urban housing and difficult to integrate within conventional market theory. (1977, p.63)

Lett contends that:

> The distinctive characteristics of housing markets makes the application of conventional market theory difficult and further contributes to cloudy understanding of its functions. (1976, p. 31)

The principal characteristics identified in the literature that are associated with housing markets include: product or housing unit heterogeneity, information and transactions (moving and search) costs, durability and fixed location of the housing stock, high supply cost relative to other commodities, and long lead time for new construction. As a consumer good, housing consumption is characterized as being relatively inflexible and immobile. In addition to these characteristics which are internal to the housing market, external factors such as taxation policy, building codes, zoning and land use policies and capital markets (interest rates, availability of financial capital) also influence the market (Arnott, 1981; Hulchanski, 1984; Lett, 1976; Quigley, 1978; Rothenberg, 1977; Runge et al., 1975; Slack and Amborski, 1984; Steele and Miron, 1984). The operational consequences of these internal characteristics and external influences can significantly affect both short and long run competitive rent levels (Hulchanski, 1984; Quigley, 1978). Further, the implications of the competitive model (as reviewed in Subsection 1.2 above) will be altered if, for example, rent regulation operates in a market where rents are above the long run competitive equilibrium level (Slack and Amborski, 1984).

This subsection begins with a review of the internal characteristics of, and external influence on, the rental housing market. Their potential impacts on rents and allocational efficiency are highlighted. The concluding part discusses the operational consequences of these factors. Distributional consequences, in particular, are noted.

1.3.1 Internal Characteristics

Among housing units there are considerable variations in structure, size, number of rooms, architecture, condition and other physical attributes. As well, there are locational and neighbourhood characteristics to be considered. The great diversity or multi-dimensional heterogeneity of housing units implies that they are not all perfect or even near-perfect substitutes for each other. The housing market is not a single market but rather a set of submarkets segmented by quality, location, size, structure and service characteristics (Blank and Winnick, 1953; Rothenberg, 1977; Steele and Miron 1984; Sweeney, 1974a, 1974b). While there may be very similar units (hence substitutability) within a submarket, the variation among submarkets suggests differing degrees of substitutability. Eckert (1983) suggests the variation in characteristics may enable landlords to demonstrate the uniqueness of their 'brand' of units. According to Eckert:

> Product differentiation done in this manner could make rental units in one building appear different from basically similar units in another building. Depending upon consumer judgement with regard to the comparative characteristics of the two apartments, different rents could be charged. In fact, location alone might in some cases be a significant factor for complete product differentiation and, hence, enable price discrimination. (1983, p. 20)(25)

This suggests that information plays an important role in the housing market. Tenants must be adequately informed about the characteristics and availability of alternative accommodation in order to determine their willingness to pay for an individual unit and to avoid paying rents in excess of those for comparable units. Landlords, on the other hand, need to know the most favourable terms that can be realized for their units and to identify suitable tenants. A housing market in which some participants possess imperfect knowledge may lead to distortions in an otherwise competitive market.(26)

In Ontario in 1971, Staranczak (1978) found that only 53 per cent of the variation in rents for modest units was explained by characteristics such as size and location. Friedman and Weinberg (1982), in an American study, utilized an hedonic index approach to control for quality, tenure, size and neighbourhood characteristics. They conclude that a substantial part of the differences in rents in Phoenix was attributable not to differences in size and quality characteristics of units but rather to differences in rents paid for units of similar size and quality. These results contrast with a competitive equilibrium in which differences in rents reflect differences in the quantity of housing services.(27)

Information is asymmetric when a person or group of people know more or less than others. In a market characterized by the inequality of information, the possibility of non-price taking behaviour may arise. Eckert (1983) contends that in Brookline, Massachusetts, information was imperfect for both landlords and tenants but was asymmetric in favour of landlords. This may have conferred some degree of market power on landlords. Such market power or influence over price and quantity is generally recognized to be sustainable only if barriers to entry exist. There is no evidence of this in Ontario.(28)

Information is costly. As well, situations may arise whereby the costs of acquiring the information necessary to make an exchange (transactions costs) are prohibitively high. Market failure may result -- a market in which exchange may not exist because of the high cost of acquiring information (Arrow, 1970). On the other hand, the necessary information may not be produced if the returns to this information are not appropriable by the producer.(29)

Examples of the approaches taken with respect to the role of information in the housing market are found in Rothenberg (1977) and Arnott (1981). In the latter study, perfect information is assumed (Arnott, 1981, assumption 2, p. 4) while in the former the period of adjustment in submarkets (which arises partly because of costly information) is of sufficient length to allow renters and landlords to fully respond to market conditions. In other words, the short run adjustment period (in which rents may be above or below those consistent with normal returns) is extended as individuals adjust consumption and production decisions after the fact.

Market participants incur transactions costs -- costs of acquiring or providing accommodation that are not included in the price of rental accommodation. For tenants these include the opportunity (time) and real costs of search and information, moving costs and psychic and economic costs related to a change in neighbourhood and living patterns (Muth, 1974; Rothenberg, 1977; Runge et al., 1975; Weinberg, Friedman and Mayo, 1981). For landlords these are thought to include advertising, management, redecorating and possibly vacancy costs. The presence and significance of transactions costs facing tenants implies that tenants are not perfectly mobile. They may not be readily able to adjust their consumption of housing services in response to either price changes or changes arising within the household (income or preferences changes).

Eckert (1983) indicates that certain tenant groups, particularly the elderly and families whose adult members work, face considerable opportunity and real costs and, hence, may experience considerable barriers to mobility.

Rothenberg suggests:

> The high costs of active participation in the market -- search, transactions, and moving costs -- imply that the prospective gains from becoming an active participant (i.e. seeking to make a change) may have to be quite substantial to warrant such participation. (1977), p. 68)

He continues:

> This suggests that a household that has just made a change is not likely to make another change very soon because of the high participation costs. So active participation is not likely to be continuous for most households but sporadic, with long periods of non-participation not uncommon. (Ibid., p. 69)

Friedman and Weinberg (1981) argue that since frequent moves are costly, once a decision to move is made, that is, the expected benefits of moving (in terms of desired housing consumption) outweigh the moving and search costs, adjustment is complete. The initial decision to move and subsequent changes in desired consumption levels are, however, affected by moving and search costs. There may be periods of time in which tenants do not move in response to changes in rents and incomes because of significant transactions costs (Muth, 1974). Weinberg, Friedman and Mayo (1981) in a study of low-income tenants conclude that the benefits of moving are small -- relatively large changes in prices or incomes result in relatively small changes in housing demand because of moving and search costs.

Partly because of information and transactions costs and because consumption is fixed spatially, demand for housing as a consumer good is considered to be immobile or inflexible. Tenants have limited ability to adjust consumption (Hulchanski, 1984; Lett, 1976; Runge et al., 1975; Willis, 1950).

Willis says:

> Most elements of the ordinary family's budget have some element of flexibility. If food costs go up, the family can usually exist on less food, or on cheaper food stuffs. If clothing costs rise, old clothes can be made to do. If the family budget no longer balances - either because costs have gone up or because the family income has gone down - economies can be made in various ways. But rent is an inflexible charge. If it goes up, the tenant has little choice but to pay or to move to a less expensive lodging, and in times of housing shortage the latter alternative is an illusory one. (1950, p. 57)

Similarly, Runge et al. suggest:

> Housing is a necessity, and a relatively inflexible budget item. That is, its consumption cannot easily be postponed or even diminished temporarily. It is not a good which can be readily substituted. (1975, p. 305)

Recent empirical evidence on price elasticities tends to support these arguments (see Friedman and Weinberg, 1981; Quigley, 1978).

Moving and search costs and inelastic demand may suggest that landlords could charge a premium (representing the costs of moving) in excess of their (landlord) costs.(30) However, Hazlett argues that:

> The existing tenant may impose costs on the landlord by moving and leaving an expensive transition period to the owner. (1982, p. 293)

Moreover, sitting tenants may have leases or receive tenure discounts. As a result, rents fully adjust only upon tenant turnover.(31) Further, as Downs (1981, p. 88) argues, small landlords, in particular, may be "turnover minimizers" rather than profit maximizers since the potential revenue loss (and costs) from a single vacant unit could be significant. Jones (1983) thinks that these landlords would only adjust rents upward once changes in demand or costs were assumed to be permanent and the consequent risks of extended vacancies small. On the other hand, in a tight market, the lack of available units reduces the benefits of moving and increases search costs for tenants (Weinberg, Friedman and Mayo, 1981), but reduces the likelihood of extended vacancies for landlords. The responsiveness of new supply is important in determining whether any rent premium is sustainable.

On the supply-side, the durability (long economic life), high cost and fixed location features of housing and the long lead times for new construction are cited as contributing to the short run inelasticity of housing supply (Lett, 1976; Moorhouse, 1972; Rothenberg, 1977; Quigley, 1978 and Runge et al., 1975).

Because housing is expensive to produce, Quigley says:

> The high costs of constructing housing imply that housing is expensive, that a large rental market exists, and that mortgage repayment makes owner-occupied housing an instrument of wealth accumulation. In addition, it makes the level of new construction of dwelling units and the occupancy costs for prospective purchasers quite sensitive to macroeconomic policy. (1978, p. 24)

Moorhouse suggests the durability and fixed location features of a rental building imply that:

> The stock of housing units rather than the flow of new construction dominates short run market considerations; and in the housing market, the short-run can be quite long. For an entrepreneur, it means that once his building is in place, changes over time in supply and demand conditions will be optimally met by price rather than quantity (quality) adjustments. (1972, p. 93)

Quigley suggests:

> Together, durability and supply cost indicate that it is typically fairly expensive to convert a unit in the existing stock from one configuration to another, suggesting that the supply curve for housing services is inelastic, even over relatively extended periods, and even if the elasticity of supply of newly constructed units is rather large. Substantial quasi-rents [returns that exceed opportunity costs] may accrue to particular units in any market run, and the long run is very long indeed. (1978, p. 25)

In other words, in the short run, supply is inelastic; price is a demand phenomenon. Rents will be determined largely by shifts in demand. If demand increases, rents will rise to ration the limited supply. Moreover, supply response lags and lengthy lead times (see Clayton Research Associates, 1984; deLeeuw and Ekanem, 1973; Grebler and Maisel, 1964 and Maisel, 1963) may extend transitional rent increases.(32)

1.3.2 External Factors

The influence of various government zoning and land use controls, housing codes and building density restrictions can be significant. Zoning and land use controls may tend to restrict supply and increase the price of housing services.(33) Frieden (1979, 1982) suggests zoning and land use controls induce builders to concentrate on the upper price levels of the housing market and may create barriers to entry particularly in local markets.(34) According to Gleeson (1979), Peterson (1974) and Sagalyn and Sternlieb (1972), zoning and density restrictions increase the value of land and consequently new supply prices. Building code administration and the zoning approval process have resulted in extended and costly delays (Frieden, 1979; Jones, 1983; Quigley, 1981).

One consequence of these effects on new supply is a spillover effect on the price of existing units. Ellickson (1977) and Katz and Rosen (1980) contend that prices of existing standardized units increase. An increase in the price of new units results in a redistribution of resources to owners of the pre-existing stock (Slack and Amborski, 1984; Quigley, 1981). The net effect of local regulations on efficiency in the production of housing depends, however, on a number of other factors.(35)

Governments directly assist various sectors of the housing market through public housing and indirectly through financial assistance. Gau and Wicks (1982) suggest, however, that subsidies for new construction, specifically the Assisted Rental Program and the Multiple Unit Residential Building program, may be dissipated in increased property values rather than in increases in new supply.(36)

The influence of capital markets on the cost and availability of mortgage and construction loan financing, and the particular vulnerability of the housing market to interest rates have been examined extensively (for example, De Rosa, 1978; Fair, 1972; Jones, 1983; Meltzer, 1974; Muth, 1962; Rothenberg, 1977 and Smith, 1971). Rothenberg suggests:

> Aggregate forces can impinge on the capital market for reasons that have little to do with the worthwhileness of housing versus other production or consumption sectors; ...Macroeconomic conditions may call for heavy use of monetary policy. This will have effects on housing far greater than on other production and consumption sectors, yet unmotivated by any real change in relative national priorities among the sectors. (1977, p. 69)

Capital market imperfections, resulting in effective non-price credit rationing, may exert a constraining influence on housing markets (Fair, 1972; Smith, 1971). Jones (1983) contends that mortgage lenders:

> Battered by unanticipated inflation, appeared to be quite slow to adapt the design of mortgage instruments (especially repayment features) and loan underwriting guidelines to an inflationary world. Intermediary financial instruments and markets that would provide mortgagors with a mechanism for hedging the interest rate and payments risks inherent in traditional mortgage instruments have also been slow to develop. (pp. 38-39)

Institutional market failure due to imperfect information in real estate financing markets as suggested by Jones (1983) and effective non-price credit rationing may result in higher rents and less housing supply than in the absence of these external factors.(37)

1.3.3 Operational Consequences

In a competitive market when supply is inelastic, rents in the short run are determined largely by shifts in demand. Conceptually, increasing rents induce new investment and construction until a new balance is reached. During the adjustment to a new long run equilibrium, income and capital gains may accrue to owners of the existing stock (Lindbeck, 1967). Most analyses consider these to be temporary as new construction increases supply, bringing rents down relative to what they would otherwise have been. However, distributional consequences within the existing rental stock may be significant if internal factors result in immobilities and adjustment lags, and external factors result in higher construction costs and corresponding higher rents for new units (Quigley, 1978; Runge et al., 1975; Slack and Amborski, 1984; Steele and Miron, 1984). Moreover, higher rents in the existing stock may be prolonged. According to Rothenberg (1977) disequilibria situations are a likely consequence of transactions costs, imperfect information, immobilities and substantial adjustment lags incurred by both consumers and producers. Further:

> Forced mismatches [of available units and consumers] at any time are unlikely to be quickly corrected because of the same barriers against continuous active participation on the user side and lagged responses on the supplier side. The past throws its shadows ahead.

> Disequilibrium situations are likely to be created and perpetrated, giving way to new forms of disequilibrium. (p. 94)

If the cost of new construction increases, the rent increases necessary to induce new supply may be substantial (British Columbia Interdepartmental Study, 1975).(38) Owners of new units earn a normal return and tenants occupying new units pay rents based on the higher costs of new supply. In the existing stock rents are higher, reflecting the high equilibrium rents (equilibrium rents would likely be lower in the absence of the external factors); however the costs (excluding the opportunity costs of capital) of providing housing services in the existing stock are less and owners earn above normal returns (Slack and Amborski, 1984). Larmour (1975) argues:

> Any theory which takes the value of the existing stock to be the cost of replacing that stock really buries the whole impact of capital gains and the attendant income transfer. Once such an assumption is granted, the whole case for rent control in its primary impact vanishes, and its utility is reduced ... to preventing momentary abuses. (p. 19)

Returns to owners of the existing stock are returns on the capital value inflated by the effects of rising new construction costs (Larmour, 1975, p. 19).(39)

As noted earlier, new rental construction is said to have experienced reduced profitability due to 'structural' changes. Larmour cites evidence of their influence beginning in the early 1970s. He suggests their negative effect on new construction makes investment in existing rental housing extremely attractive. Further, in the absence of regulation with levels of new construction reduced, the tax sheltering, leveraging and depreciation incentives(40) would encourage rapid turnover of existing rental properties. He says:

> Relating these conclusions back to the earlier considerations on the effect of a rise in building costs on capital gains in the housing market, the real impact of the earlier findings come to be felt. For if there is a large turnover, this means that the capital gains tend to become realized capital gains; and from being in a sense hypothetical costs, the inflated value of the existing stock becomes real costs. (Larmour, p. 29)

Larmour's analysis would appear to provide a basis for Achtenberg's conclusion that:

> In the uncontrolled market, the landlord's ability to capitalize excess profits into increased property value results in higher debt service, higher taxes, and once again higher rents. By reducing and possibly stabilizing cash flow profits, rent control should also have a stabilizing effect on property values insofar as values reflect net income and expectations of future gain. To the extent that rent control succeeds in interrupting this circular process, there should be important secondary impacts on the more substantial components of the rent dollar, with cumulative cost savings to tenants over time. (1973, p. 439)

1.4 Summary

A number of effects have been examined as possible consequences of rent regulation. These include effects on: rents and capital values, the quality and quantity of services from the existing stock, consumption efficiencies and levels of new construction. The theoretical literature argues that landlords who either anticipate or experience a return under regulation that is less than a market (competitive) return will seek to reduce the supply of housing services. From the empirical literature it is much less certain that the predicted reduction is occurring. Differences in regulatory programs, rent adjustment mechanisms, market conditions and maintenance technologies are cited as being important determinants of the effects of a specific regulatory policy. Given this, the number of other factors influencing the rental housing market and the difficulties in measuring the possible efficiency effects of rent regulation, further research is required.

Two suggested areas (see Slack and Amborski, 1984) for further research concern the existence and nature of imperfections in the rental market and, secondly, better estimates of supply responses to changes in demand and the impact on rental starts.

Notes to Section 1

(1) Efficiency is optimized at a quantity such that if more housing were supplied its cost would exceed the price that the market would be willing to pay for it. Also, if less housing were made available, the cost saving would be less than what the market would be willing to pay for the supply that was eliminated.

(2) A unit of housing service is a hypothetical concept reflecting the various attributes such as size, design, fixtures, location and other characteristics of a dwelling unit to which consumers attach value. A dwelling unit yields some quantity or flow of housing service in each time period. An apartment which provides twice the consumption value of another is said to yield twice as many units of housing service. See Olsen (1969).

(3) Cut backs in maintenance expenditures may be viewed as either reducing the quantity of housing services supplied or as adjustments to the profit maximizing quality of the housing services supplied. Generally, the housing literature does not make a distinction between quantity and quality. See Olsen (1969) for example. Non-housing studies model demand as a function of both quantity and quality. See Dixit (1979), Dixit and Stiglitz (1977), Sheshinski (1976), and Spence (1975).

(4) If supply is elastic, there will be an incentive for the landlords to reduce the quantity of housing services supplied until the marginal cost of a unit of housing services just equals the regulated price. Consequently, any services for which the marginal cost to the landlord exceeds the regulated price (but not the competitive price) will be eliminated as a result of the imposition of regulations.

(5) Although binding rent regulation unambiguously reduces gross revenues in the short run, the long run effect on gross revenues and the effect on net revenues are not clear.

(6) Frankena (1975) argues, however, that Moorhouse has confused the two forms of rent regulation (footnote 4, p. 303) and Kiefer (1980) suggests that Moorhouse assumes that rent regulation reduces maintenance (footnote 10, 59).

(7) Capital values are based on anticipated future rents. As argued in the financial literature anything affecting anticipated future rents (whether increases in costs, or a restraint on rent increases, for example) will result in a one-shot

reduction in capital values. Subsequent purchasers of a property would earn a normal return on the adjusted value. In an opportunity cost sense, owners of the existing stock would earn a normal return on an asset whose value has declined. Excess demand is examined in the next subsection and capital values in subsection 1.2.4 (below). The distributive effects of rent regulation are examined in Section 2 of this paper.

(8) Landlords would incur costs in applying for rent review. These would likely be included in determining the permitted rent increase. Under tight market conditions it is likely that a rent increase for improvements could be passed on to tenants. Although Smith and Tomlinson (1981, 106) and Ontario-MOMAH (1982b) suggest there are particular features of the cost pass through system in Ontario that discourage maintenance and capital improvements, an allowance for interest on capital expenditures is built into the rent permanently (Slack and Amborski, 1984).

(9) It may also indicate planned quality reductions as suggested in the quality filtering concept of the housing market. See Arnott (1981), Grigsby (1963), Rothenberg (1977) and Sweeney (1974a, 1974b).

(10) See also Achtenberg (1974) and Clark, Heskin and Manuel (1980).
Klein and Sears et al. (1983) express the concern that existing pass through guidelines may discourage Ontario high-rise landlords from undertaking long term conservation expenditures.

(11) Los Angeles, the market for the Rydell et al. (1981) study, has a vacancy decontrol provision in addition to new unit exemption in their legislation. This may deter landlords from reducing the quality to market-clearing levels at the regulated rent if tenants could move to the exempt sector. On the other hand Fallis (1984, footnote 22, p. 60) and Frankena (1975, footnote 9, p. 305) argue that with vacancy decontrol landlords would seek to reduce quality and services. Brookline, Massachusetts allows rental units to be converted to condominium status. In this case landlords may not reduce maintenance and quality that would affect the market value as a condominium.

(12) Rydell et al. (1981) indicate that landlords in Los Angeles, in the absence of regulation, set initial rents for new tenants higher than market average (presumably under tight market conditions). Subsequent rent increases for continuing tenants are less (tenure discounts). Clark and Heskin (1982) suggest that rent increases occurring for vacancy decontrolled units in Los Angeles indicate full adjustment by landlords for normal tenure

discounts and for tenure discounts due to rent regulation. See footnote 11.

Empirical analysis of the effects of rent regulation on rent levels in Ontario is examined in subsection 1.2.4 (below).

(13) See footnote 12.

(14) Tenure conversions to ownership occur through the conversion of multiple unit rental buildings to condominiums, the deconversion (consolidation) of small buildings containing several units to single family residences and single family rental to ownership. Conversions are subject to zoning and land use regulations, conversion costs, and the effects of financing availability on demand.

(15) Based on a study by the City of Toronto Planning and Development Department. See City of Toronto (1980).

(16) The City of Toronto study lists the following reasons for these reconversions: a splitting of related households formerly sharing the building to minimize shelter cost; increased household size and space requirements by owning households; increased equity build-up by owners; a reduction in demand for this type of dwelling; sales for single occupancy or to an absentee owner; rent control; non-reporting at the time of enumeration.
See also Klein and Sears et al. (1983) for an analysis of stock losses in the City of Toronto.

(17) Kristoff (1981, 1976) and Marcuse (1979) examine the New York City market.

(18) See Appelbaum (1983) and Gilderbloom (1980, 1981) for a review of several studies in the United States. Their own studies suggest a link between rent regulation and new construction cannot be established when external influences are taken into account.

(19) See Arnott (1981), Smith (1974) and Rosen and Smith (1983) for a discussion of rent increases as a lagged function of vacancy rates, market conditions and operating cost increases.

(20) See Arnott (1981, 176-178) for qualifications concerning the model.

(21) The use of hedonic indices is extensive in analyses on housing quality and rents. See Ball (1973), Butler (1982), Jazairi (1982), Kain and Quigley (1970, 1975), Marks (1984), and Merrill (1980).

(22) For estimates in other jurisdictions see DeSalvo (1971) and Olsen (1972) for New York, Marks (1984)

for Vancouver, Rydell et al. (1981) for Los Angeles.
Steele and Miron (1984) review the Ontario literature exclusive of the Fallis and Smith (1984b) study.

(23) Ontario-MOMAH (1982a) includes the data from both studies; Slack and Amborski (1984) provide a review of these studies.

(24) For a discussion of the effects of regulation on capital values in other jurisdictions see Appelbaum (1983), Campbell (1981), Eckert (1983), Gilderbloom (1981), and Shulman (1981).

(25) In a competitive equilibrium, locational rent differentials generate a spatial equilibrium with consumers making a trade off between location and rent.

(26) Imperfect information may be a source of market failure or inefficient resource allocation. See Layard and Walters (1978, 22-26 and chap. 13).

(27) See Olsen (1969).

(28) See Markusen and Scheffman (1977) and Muller (1978). See also Clayton Research Associates (1984) and Ontario-MOMAH (1982a) for a discussion of market structure in Ontario. Zoning restrictions may limit entry in some cases. This is examined in subsection 1.3.2 below.

(29) In this instance information may be a "public good"; one possible source of market failure. See footnote 26. Transactions costs are discussed below.

(30) In this case because of transactions costs, a negative externality exists. The cost to society is greater than the private cost of production and may result in inefficient resource allocation. See Arrow (1970, 64-69), Dahlman (1979) and Layard and Walters (1978, 189-191) for a discussion of externalities as a source of market failure.

(31) For a discussion of tenure discounts and some empirical evidence see Clark and Heskin (1982), Follain and Malpezzi (1980), Goodman and Kawai (1982), Kain and Quigley (1975) and Merrill (1980).

(32) For a discussion of a widely held representation of the interaction of rents, vacancy rates and new construction see Clayton Research Associates (1984, 13-15) and Rosen and Smith (1983).

(33) See Colwell and Kau (1982), Dahlman (1982), Dowall (1980), Dowall and Landis (1982), Fallis (1981), Frankena and Scheffman (1980), Frieden (1979,

1982), Katz and Rosen (1980), Maser et al. (1977), Mills and Oates (1979), Muller (1978), Muth and Wetzler (1976), Quigley (1981), and Stull (1974, 1975).

(34) See also Dowall (1980).

(35) See Quigley (1981, 49-50). Quigley also reviews empirical studies related to zoning, land use, density and building code restrictions. See Silver (1980) for an analysis of building codes.

(36) The aim of the Assisted Rental Program initiated in 1975 by the federal government was to stimulate construction of rental units through the provision of direct grants or interest free loans. The Multiple Unit Residential Building Program initiated about the same time was to encourage construction by reducing the impact of 1972 federal income tax revisions which limited the tax shelter benefits of real estate investment.

(37) Other external influences that can be attributed to government policy include tax policy as well as the interaction of inflation and tax policy on tenure choice. See Diamond (1978), Hendershott (1980, 1982), Hendershott and Hu (1981), Jones (1983), Rosen and Rosen (1980), and Smith (1983).

(38) The British Columbia study provides an example indicating that to ensure $30,000,000 of new construction an 'unearned' (windfall) capital gain of $97,000,000 is created for owners of the existing stock (1975, 294-295). See Clayton Research Associates (1984), Fallis (1984) and Jones (1983) for a discussion of anticipated and unanticipated changes in demand and inflation.

(39) See Kaish (1981) for a discussion of 'fair' returns based on both historic costs and current or replacement costs. See Lett (1976) and Willis (1947) for a discussion of rate of return regulation.

(40) See Larmour (1975, 22-29) for a discussion of these aspects. See also Jones (1983) and Smith (1983).

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SECTION 2: THE DISTRIBUTIVE EFFECTS OF RENT REGULATION

2.1 Introduction

The purpose of this review is to outline the conceptual issues and empirical findings that are set out in recent literature on the distributive effects of rent regulation. Determining these effects is a complex task since as Achtenberg (1973) points out:

> Redistribution operates not only between landlords and tenants of rent controlled housing but also between owners of controlled and exempt buildings and between protected tenants and other housing consumers. (p. 439)

The review begins with a brief discussion of the criteria used to assess the distributive impact of government policies. Subsection 2.3 looks at the conceptual issues related to the operation of rental housing markets. Subsections 2.4 through 2.6 concentrate on the empirical estimates of the effects of rent regulation on rent levels in Ontario. Subsection 2.7 examines the possible complications of a dual market system as well as rationing of available units if scarcity develops. Subsection 2.8 describes some of the indirect effects between the rental and homeownership markets. Administrative and public costs are the focus of subsection 2.9.

2.2 Evaluation of the Distributive Effects of Public Policy

Several papers discuss the general criteria used to evaluate the effects of public policy and the application of these criteria to the assessment of rent regulation. These papers include: Arnott (1981), Fallis (1981), Fallis (1984), Hulchanski (1984), Miron and Cullingworth (1983), Ontario-MOMAH (1982) and Slack and Amborski (1984). Two principal considerations are efficiency and equity.(1) Since efficiency considerations are reviewed in Section 1, this section concentrates on the measurement and equity aspects of the distributive effects of rent regulation in Ontario.

Hulchanski notes the difficulties associated with equity issues:

> Whereas economic efficiency can be defined and to some extent measured, equity, as more of an ethical concept, concerned with what people consider to be fitting or right, is much more difficult to define. (1984, p. 57)

According to Fallis:

> If the situation is unfair, a program might be mounted to redistribute resources to deserving households. The question is especially difficult to answer for policy analysts because their training, however excellent, gives no guidance about what is fair. It is an issue of justice, rather than social science. (1981, pp. 12-13)

Fallis (1981) states that it is generally accepted in public policy that:

> Redistribution should conform to the principles of horizontal equity -- that similar households receive similar assistance and vertical equity -- that households in greater need receive greater assistance. (p. 13)

Arnott (1981), in reference to this issue, argues that "according to the commonly accepted view of social justice, redistribution should occur from all the rich to all the poor." (p. 28)

In applying these criteria to rent regulation, Miron and Cullingworth say that:

> It may be unfair to assess Rent Review as a general redistributive tool. That is not its only, or even major, objective.(2) (1983, p. 171)

Still, Miron and Cullingworth and other authors have spent a considerable amount of time assessing the distributive impact of rent regulation in Ontario. Fallis (1984) provides one motivation:

> Should regulation be used in pursuit of other social objectives, its effect on the distribution of income is of interest because society does wish the distribution of income to remain fair. Any change caused by rent regulation should be horizontally equitable and, most people would agree, should also be neutral or slightly progressive. (p. 46)

Miron (1981), Ontario-MOMAH (1982), and Slack and Amborski (1984) present a number of conceptual difficulties which arise in attempting to measure the distributive effects of rent regulation. Ontario-MOMAH says that these problems result because the analyst must:

1. establish a base from which the change is measured;
2. determine the resulting distribution to which the base is compared; and
3. find the criteria relevant to the evaluation of the change.

In choosing a base, the Ministry reasons that the use of a particular point in time "may be one that is particularly beneficial to one side of the issue." Some alternate bases are described:

> An advocate of free markets would argue that the comparison should be between controlled and fully uncontrolled rental levels. In contrast, others might seek the elimination of landlord profits and the interest return to financial capital. An intermediate position would look to an orderly, phased return to market conditions. (Ontario-MOMAH, 1982, p. 125)

Moreover, Fallis (1981) maintains that "housing programs should be recognized as part of the larger income support system" (p. 13). Ontario-MOMAH (1982) tends to support Fallis's argument:

> A wider study might consider the distribution of benefits and costs over all housing programs and so include low income government subsidies and ownership tax benefits in the balance. (p. 130)

2.3 Market Concepts and Distributive Effects

Several papers address Fallis's question -- would the distribution of income be unfair without government intervention? Achtenberg (1973), the British Columbia Inter-Departmental Study Team (1975) and Hulchanski (1984) reason that regulation of rent levels may be necessary, not to effect an equitable distribution of income, but rather to stop inequitable redistribution from tenants to landlords during times of housing shortages.

On this point, Miron and Cullingworth (1983) cite the Brief to the Standing General Government Committee on Rent Review which argues that:

> Excess profit for the landlord represents a direct re-allocation of income from tenant to landlord. Rent control should not be used to re-distribute income positively, but controls must be placed on the negative re-distribution which is inevitable where tenants are poorer than landlords, which by and large is the case in Ontario. These countervailing equities are not solved by free market forces of supply and demand. The social cost of the corrective response to scarcity is simply too high. There is no equality of 'bargaining power': there is discretion, expertise and economic power on the side of the supplier of rental accommodation, and none of these on the side of those who require accommodation. (p. 149)

Achtenberg and the British Columbia Inter-Departmental Study Team outline possible reasons for rental housing shortages and why such shortages may be translated into higher rent levels. These supply-side reasons include:

1. Housing supply is not readily adaptable to demand pressures -- planning, approval, and construction of new units take a considerable length of time.
2. If costs of new construction have risen, the rent increases necessary to stimulate construction may be large. This occurs even though new construction represents only a small percentage of the overall stock of rental units. These two characteristics contribute to what is commonly referred to in the papers as inelasticity of supply -- that changes in supply are slow to react to changes in prices, at least in the short-run. Loikkanen (1983) reasons that population growth in urban areas is often the reason for instituting rent regulations if supply is slow to react to the increased demand.

3. Achtenberg adds that the problem may be compounded as "landlords' ability to capitalize excess profits into increased property values results in higher debt service, higher taxes and once again higher rents." (1973, p. 439)

Hulchanski discusses further characteristics of housing which "tend to complicate the ability of housing, and in some cases rental housing in particular, from functioning as a typical market commodity" (1984, p. 33). Because these characteristics are reviewed in Section 1, they are only listed here: high transactions costs, capital costs, durability and heterogeneity of housing stock, fixed location, and existing government regulations other than rent regulation.

In contrast, studies which maintain that the rental market is fundamentally competitive include: Arnott (1981), Clayton Research Associates Limited (1984), Fallis (1981), Goldberg (1983), Jones (1983), Smith (1983) and Smith and Tomlinson (1981). In his discussion of several of these papers, Hulchanski (1984) observes that:

> The conventional assumption is that the problems with the rental sector are simply a temporary aberration in the performance of the private market mechanism. The rental market mechanism is not viewed as the problem. It is argued that we are not witnessing failure of the market to function, but that, if government policy creates the right conditions, the private market can solve the problems currently being experienced in the rental sector. (p. 12)

Arnott says that:

> While there are many noncompetitive aspects of the housing market, barriers to entry are small. ...In reality, high rents reflect scarcity and high costs far more than they reflect the monopoly power exercised by landlords as a group. (1981, p. 26)

Fallis (1981) adds that:

> High prices act as signals to draw resources into the housing sector. If prices remain high in the long run it may be an indication that resources needed to expand the quantity of housing have valuable uses elsewhere. For example, the land might be used in agriculture, the labour in building new factories... (p. 15)

Smith and Tomlinson also imply that, on its own, the rental market operates competitively and efficiently. They suggest that any distributive benefits may be outweighed by the efficiency losses, essentially through resource allocation distortions:

> Rent control in Ontario has significantly reduced the real (and to a lesser extent the nominal) value of rental apartment dwellings, substantially inhibited rental construction, generated rental shortages, created a dual controlled and uncontrolled rental market in which rents in the uncontrolled sector are higher than they would have been in the absence of controls, encouraged deterioration in the quality of the existing housing stock, and imposed a large revenue and expenditure cost on government and hence on the non-rent controlled public. (1981, p. 111)

2.4 The Distribution of Direct Costs and Benefits Among All Households

Studies which provide empirical estimates of the distributive effects of rent regulation in Ontario include: Fallis (1980), Miron (1981a), Blatt (1982), Ontario-MOMAH (1982), and Miron and Cullingworth (1983).

All of these studies are based primarily on Statistics Canada's Household Income, Facilities and Equipment Surveys (HIFE) and employ similar methodologies.

2.4.1 Estimates of the Distribution of Rent Savings

Miron and Cullingworth (1983) calculate that the potential income transfer is substantial -- for each one per cent that rent regulation kept rent levels below market levels (rental gap), tenants saved an estimated $21 million in 1978. The authors add that it is impossible to determine the exact rental gap. Blatt states that "there is no certain way of knowing precisely to how much that transfer (or lack of transfer) amounts" (1982, p. 22). She provides an estimated rental gap of 7.5 per cent for Ontario in 1978.(3)

Smith and Tomlinson (1981) estimate that real gross rents declined between 11 and 12 per cent from July 1975 to the end of 1980.(4) These figures contrast Miron's observation that "the overall rate of increase in rents in Canada bears about the same correspondence to inflation in the CPI since 1976 as it did in the quarter-century before 1976" (1981a, p. 3).

Using the assumption that rents were reduced by one per cent in 1978, Miron and Cullingworth employ the HIFE Survey to formulate the net impact through rent savings and losses on all Ontario households.(5) They found that "the largest net benefits have accrued to the lowest income groups and the largest net losses have been in the upper income groups" (1981, p. 153). The average net benefit for all households earning under $4,000 annually was estimated to be $6 in 1978. The only group to suffer an overall loss was the group earning over $25,000 per year. This was reported to be just under $10 per household for 1978. The authors maintain that rent review was generally vertically equitable in distributing costs and benefits. Ontario-MOMAH (1982) supports this finding by stating that:

> The total cost of the rent reduction is shared more heavily by the higher income groups, with slightly over half of the cost being borne by the highest income group and almost three quarters by the two highest. Almost one quarter of the burden was, however, borne by the lowest four income classes. (p. 127)

It should be pointed out that these figures only fulfill the vertical equity criterion for the 'average' household. Homeowners, for example, do not share in the rent benefits no matter what their incomes are. Discrepancies among tenants as well as estimates of rent benefits among those who receive these benefits are discussed later in this review.

Miron and Cullingworth provide estimates of the 'direct rent impacts' for nine different household types. Some of their findings include:

1. The net benefits of rent review accrued mainly to those with household heads under 35 years of age while net costs accrued mainly to households whose heads are 50 or older.
2. Similarly, persons living alone and under 35 years of age received a large net benefit as they had

little investment income (used to approximate landlord income).

3. Households with children over six and both spouses present incurred a net loss. A high portion of these households were homeowners.
4. The elderly and 2-plus person households also incurred a net loss. This may be because many elderly were either homeowners or occupied government assisted housing.(6) Neither of these two groups received any direct rent benefits. However, the latter received public assistance and might be considered net beneficiaries of overall government programs.

Miron and Cullingworth conclude that:

> Not all of the young are large net benefitters and not all of the elderly are large net losers. Whether or not a person lives alone is also important. At all ages, those living alone are more likely to be net benefitters and those resident with others, net losers. Principally, this is because those living alone have lower incomes, a lower NIFI, [average investment income of household] and a greater likelihood of being a renter in Review-covered accommodation. (1983, p. 168)

2.4.2 Estimation Limitations

There are estimation problems, including data limitations, which affect these studies. Miron and Cullingworth (1983) provide the following:

1. HIFE does not provide a means of estimating what rents would have been in the absence of rent review.

2. Information on upper income households is not published.
3. The survey does not provide information on landlord income. In order to overcome the lack of rental investment data, rental investment is assumed to be distributed in the same manner as overall investment.
4. 'Foreign landlords' are not accounted for in HIFE. Thus, the loss incurred by Ontario landlords may be overstated.
5. Effects are assumed to be proportional. That is, tenants and landlords are thought to react in the same manner whether there is a 1 per cent reduction in rents or a 10 per cent reduction.
6. The gains and losses are also assumed to be proportionately distributed. For example, Blatt's estimated 7.5 per cent rent reduction is an average but is applied uniformly across regulated tenancies.
7. HIFE does not distinguish between regulated and unregulated tenancies. Most of these studies are based on 1978 data. This was before the $750 per month exemption was enacted.

Due to such limitations, Fallis (1980) warns that the results should only be considered a rough approximation of the short-run effects of rent regulation.

Part of the literature also addresses the difficulty of measuring the value of tenants' benefits -- not in dollars, but rather in housing services at reduced costs. Such in-kind payments may tend to reduce the overall benefit to the recipient:

> The essential property of an individualistic social welfare function is that it respects consumer sovereignty. It assumes that an individual is better off if he alone chooses how to spend a given sum of money or himself,...Income redistribution is 'lump sum' when the government determines how much to give a recipient on the basis of his intrinsic characteristics, rather than on the basis of his actions. (Arnott, 1981, p. 19)

Olsen (1972) reports that the cost of rent regulation to landlords in New York was twice its direct benefits to tenants (including other costs as discussed in subsection 2.6). Miron and Cullingworth claim that for Ontario, there was a more modest benefit loss of between 4 and 6 per cent due to tenant payment in-kind. They formulated 'real income equivalents' using different measures of tenant satisfaction (utility functions) and assumptions as to the demand for housing relative to other consumer goods (elasticity of substitution).

2.5 Distribution of Direct Benefits Among Tenants

Evidence exists that tenants, on average, earn low incomes relative to other households. Miron and Cullingworth (1983) provide some support:

> Those of low incomes are much more likely to rent than those with higher incomes. In 1974, in the nine Ontario urban areas surveyed, 61.1 per cent of those with incomes under $10,000 were tenants, compared with 40.7 per cent of those with incomes from $10,000 to $19,999; and 21.0 per cent of those with incomes of $20,000 or over. (p. 151)

Similar findings are reported in Section 3, Rental Housing Affordability.

Empirical studies by Blatt (1982), Fallis (1980), Miron and Cullingworth (1983) and Ontario-MOMAH (1982) provide evidence to suggest that Ontario's rent regulation is generally progressive in distributing net benefits among tenants. Fallis provides estimates of tenant rent savings that are progressive throughout all tenant income groups. Blatt also calculates that the net direct benefits to unsubsidized tenant households were, on average, progressive in 1978. Based on a 7.5 per cent rent reduction the author found that tenants earning under $4,000 received net benefits equivalent to 7.2 per cent of their income. This figure declined as household income rose. Those earning $25,000 or more had rental savings equivalent to 0.3 per cent of their income.

However, the criticism that rent regulation offers assistance to high and middle as well as low income tenants is put forth in several papers. Miron and Cullingworth reason that:

> Perhaps the main problem in using rent review to rectify housing affordability problems is that it is a very blunt tool. Rent review keeps rents down for problem households by reducing them for all unsubsidized renter households. (1983, p. 171)

This is reinforced by Achtenberg:

> The basic shortcoming of rent control as a redistributive measure lies in its application to categories of housing, rather than to categories of housing occupants. (1973, p. 441)

Ontario-MOMAH (1982) points out that the average annual rent benefit in dollar terms shows a clear pattern of increase with income. This is because high income tenant households tend to rent more expensive units. The Ministry found that the average tenant in the highest income group received a rent savings of slightly over 40 per cent more than the average dollar benefit for the lowest income group. According to Blatt's estimates, nearly one-half of the households protected by rent regulation in Ontario earned more than $15,000 in 1978. Moreover, this group was estimated to have received just over half of the rent savings. However, the Ministry states that this tendency is offset by the pattern of average costs which also rise with income, as discussed in subsection 2.6.

Based on the same study, the Ministry reports that:

> The estimated rental savings of tenants with children is less than the savings of non-elderly childless individuals and couples. (p. 10)

This study submits that the rent review program in Ontario is redirecting income into the hands of those groups in society who are not the most in need. The Ministry adds that because 70 per cent of the tenants do not have an affordability problem, only about one in four dollars of benefits goes to the estimated 30 per cent that do have a problem.

2.6 Distribution of Direct Costs Among Landlords

In considering the landlord's position, Miron and Cullingworth briefly discuss several studies which provide little confirmation that landlords tend to earn high incomes. Policy Options for Continuing Tenant Protection (1978), in its analysis of the Canadian situation, states that:

> Income problems are experienced by landlords as well as by tenants. The 1974 Survey of Housing Units revealed that there were some 38,000 rental building owners who lived in the buildings they owned. Of these, about 35 per cent had incomes $20,000 and over. The average income was slightly under $14,000. (p. 7)

Heung (1976) employed Revenue Canada taxation figures for rental income to obtain some idea of the relative income position of landlords and tenants nation-wide. Heung comments that:

> The results of this investigation...are at variance with the common impression that landlords are rich and tenants are poor. However, these results are, at best, only indicative since much of the total rental income received in Canada is received by corporations. In order to provide a complete analysis of the distribution of rental incomes by income class, it would be necessary to determine the income of each shareholder of the corporations. (p. 75)

As stated earlier, the HIFE Survey does not provide separate information on landlord income but does present data on overall investment income. Under the assumption that landlord income is distributed in the same manner as overall investment income Blatt calculates the direct loss of rental income in 1978 as a percentage of average household income for six income groups. The loss does not progress evenly through most income groups. For those earning less than $4,000 per year the loss is 0.5 per cent. It increases to 0.7 per cent for those earning between $4,000 and $7,999. For those earning over $25,000 the loss is 0.3 per cent. Ontario-MOMAH concludes that in dollar terms, "the total cost of the rent reduction is shared more heavily by the higher income groups" (1982, p. 127).

The Ministry also presents Canada-wide data to approximate landlord investments among various Ontario household income groups. It concludes that the major losses fall on the minority who are landlords, while the majority of households earning equal income escape this effect, thus violating the horizontal equity criterion. (Ontario-MOMAH cautions that this statement ignores rental ownership through pension funds.) The Ministry contends that:

> Rent review by definition does not produce a result that provides equal benefits or costs to those of similar incomes regardless of their tenure choice or choice of investment. (1982, p. 130)

Another suggested inequity is that some landlords may benefit from rent regulation although general rent levels are held below the competitive level:

> A landlord who had only buildings not covered by the regulation may be on either side of the equation. A landlord whose buildings had experienced high vacancy rates before controls probably has not suffered greatly, as the low vacancy rates that accompanied rent review

> have probably given him more tenants and perhaps a net gain. (Blatt, 1982, p. 22)

Gilderbloom (1983) explains the distribution of costs among landlords as follows:

> When a municipality sets allowable rent increases, landlords may act to target their rent increases at that level. This would include all landlords who might not have raised their rents to that level in a non-rent controlled situation. Thus the professional landlord who wants to raise rents by a large amount is thwarted, but at the same time the amateur operator raises rents higher than he or she would have without controls because 'fair and reasonable return' is now made explicit. The result may simply be a reduction in the variation in rent levels throughout the city. Adoption of moderate rent control by municipalities, for the most part, appears to be a gesture more in symbolic politics than in redistributive politics. (p. 19)

Arnott (1981) and Slack and Amborski (1984) raise the possibility that landlords who own rental units at the time rent regulations are introduced may incur all losses through reduced capital values.(7)

As Arnott says:

> The loss to a landlord comes in the form of a sudden reduction in the value of his property upon the imposition of controls. It is the landlords who own property when controls come into effect who lose; subsequent owners are neither hurt nor helped by controls. (1981, p. 54)

Smith (1981) in a report for The Real Estate Institute of Canada furnishes statistical support for Arnott's view. Smith found that the real price per Ontario rental unit declined by 39 per cent between 1975 and 1980. He also maintains that the selling price of apartment units fell by 30 per cent relative to the price of single family homes (p. 4).

Additional Landlord Costs

Additional costs may be incurred by landlords of the regulated stock.

Kriegsfeld (1975) argues that, depending on the specific rent regulation scheme, the administrative costs of rent regulation may increase the expenditures required of landlords without increasing their income. Deadlines for filing notices of rent increase, the use of proper forms, meetings with rent commissions and other regulatory authorities, all may go to increase the financial burden to the landlords.(8)

Blatt (1982) suggests that the cost of compliance to rent review legislation may be a very real cost to landlords and especially to small landlords. Large corporate landlords have access to legal assistance and maintain records of all their financial transactions. Blatt maintains that most small landlords do not have legal advice on hand and find that the costs involved in going through the review process are more than the value of the increase sought. No data could be found on this item. The best source of information may be the Annual Reports of the Ontario Residential Tenancy Commission which list applications for rent increases by building size.

Lett (1976), in discussing the rent adjustment process in several American jurisdictions, contends that the price of administrative lag, especially in times of inflation, may well be the permanent loss of a building. By the time an increase is secured, costs may have already increased to the point that another increase is necessary -- creating a cycle in which the securement of increases always lags behind the actual cost realities. She reasons that administrative lag time may well be the economic downfall of owners of small structures who lack sufficient capital reserves to compensate for the gap between income and costs.(9)

The Annual Reports of the Ontario Residential Tenancy Commission indicate that the number of applications for rent increases and consequently the average processing delay rose significantly in the early 1980s when inflation rates were high. However, no data on the effects of processing delays were found.

2.7 Dual Markets, Excess Demand and Availability of Regulated Units

The possibility of excess demand for regulated units and the creation of a dual rental market through exemptions, for example, luxury units, new buildings and furnished apartments, both tend to complicate tenant equity. Tenants are similarly split into two categories -- those who are protected by regulation and those who rent on the open market.

Excess demand for rental units may exist when rent regulation is introduced. Several papers argue that, if rents are held below competitive levels the extent of the excess demand may increase and new investment may not be forthcoming to alleviate the excess demand. They include: Arnott (1981), Blatt (1982), Miron and Cullingworth (1983), Stanbury (1984), and Smith and Tomlinson (1981). The possible reduction in investment is an efficiency consideration and is discussed in Section 1 while rental housing shortages are looked at in subsection 2.3. This subsection outlines the perceived effects on tenants when there is excess demand.(10)

2.7.1 Rationing

Arnott discusses three possible rationing mechanisms for housing when excess demand exists:

> 1. The rational law-abiding landlord will choose easy tenants, those who will stay a long time, look after their apartments well, and not be a nuisance to their neighbours. If he feels that these characteristics are positively correlated with income, he will probably ration on that basis.
> 2. If he is required by law not to discriminate in this way, his apartments may go to those who have been on his waiting list the longest.
> 3. He also has a strong incentive to ration illegally, by demanding key money.
>
> (1981, p. 55)

Arnott argues that, given a mix of these three rationing mechanisms, high income households are clearly winners. The quality-adjusted rent on unregulated housing constructed after regulation has been imposed is likely to be much the same as it would have been in the absence of regulation. As a result, high-income households who live in unregulated housing are about as well off as they would have been in the absence of regulation, while the high-income households who live in regulated units are presumably better off, since they have chosen it over unregulated housing. This conclusion appears, however, to overlook key money deposits and the possibility that landlords use waiting lists rather than rationing by income (Cheung, 1975; Frankena, 1975; Moorhouse, 1972). A further complication, discussed subsequently is that rents in the unregulated sector may be higher because of the introduction of rent regulation.

Arnott (1981) also maintains that short-run distributive effects on the middle and low income groups are ambiguous if rationing exists. Scarcity of medium-quality regulated housing may force some middle income households to settle for low-quality regulated housing or unregulated higher-quality housing, while others, because they are good tenants, may obtain regulated, high-quality housing.

For low income tenants, the relative abundance of low-quality housing helps them since they are likely to be able to obtain, at lower rents, more or less the same housing they would have chosen in an unregulated market. But because they are likely to be regarded as less desirable tenants than the middle income households now competing with them for the same quality housing, the rationing mechanisms work against them.

Loikkanen (1983) tends to support Arnott:

> When prices cannot be differentiated among different types of buyers, it pays to wait for a preferred type of customer and discriminate the other type for some time at least. This creates an 'availability problem' to the non-preferred buyers. (p. 37)

However, no empirical evidence was found to support or refute this argument.

2.7.2 Tenant Costs

Blatt (1982) reasons that the only real dollar cost to the majority of tenants is in the cost of the rent regulation program. However, several papers raise the possibility that some rents may not be lower as a result of rent regulation (Smith and Tomlinson, 1981; Blatt, 1982; Mann and Veseth, 1983). Two cases are suggested. In the first case, tenants in units not subject to regulation may find that their rents may not be lower and may be higher than they would otherwise have been. In the second case, rents may be higher for those tenants whose landlords would not have raised rents as much as the allowable percentage, but do so because a ceiling exists. No empirical evidence could be found to support this latter proposition.

Smith and Tomlinson (1981) believe that the most important feature that comes out of dual markets is the fact that rents are going to be higher in the unregulated sector than they would have been in the absence of rent regulation.(11) As proof, they report that in the City of Toronto in October 1980, rents for unregulated bachelor, one-bedroom, two-bedroom and three-bedroom units were, respectively, approximately 23 per cent, 34 per cent, 26 per cent and 10 per cent higher than for equivalent regulated units.

These differences were estimated from preliminary data supplied by the CMHC Toronto office, "Rental Ranges in the sample of Privately Initiated Apartment Structures of Six Units or Over", November 1980. Smith and Tomlinson (1981) qualify their figures noting that, since unregulated units were all completed after rent regulation was introduced and were thus less than 5 years old, there are likely to be qualitative differences which would cause observed percentages differences in average rents. In a footnote, the authors argue that the likelihood that newer unregulated units are less well-located and hence have a lower location value partially offsets the age bias.

Blatt (1982) lists several indirect tenant costs which tend to offset rent reductions. These costs may result from lost mobility through low vacancy rates, lost money through increases in key money payments and black market activities, loss of privacy due to real shortages of units which could lead to doubling-up, a change in the life pattern, differing levels of maintenance and, to the extent that they may have been so employed, a decline in employment in the construction industry.

According to Mann and Veseth (1983):

> Renters -- individuals living in rent-controlled housing -- experience both gains

> and losses from rent control. The obvious gain comes from below-equilibrium rents -- an income transfer from landlord to renter. But it is important, following Cheung, to note that the size of the gain is generally less than the amount of the rental differential itself. Under rent control, renters compete for scarce price controlled units. Search costs, queue lengths, and side payments are all likely as mobility, housing quality, and vacancy rates fall. Sitting renters experience a "lock-in" effect. The initial gains to renters are thus dissipated over time. (p. 33)

With the presence of low vacancy rates, Blatt and Arnott suggest that a limit on mobility may be a very real cost to tenants who do not like the unit that they reside in or whose requirements have changed:

> A tenant is discouraged from moving within the local rent-controlled housing market because the search costs of finding a preferable unit are high when there is excess demand. And he is discouraged from moving to a jurisdiction without rent control because he would have to pay more for comparable housing. This creates inefficiency in the labour market. Reduced mobility also results in a mismatching of households to housing units. (Arnott, 1981, p. 21)

Empirically, evidence has been conflicting. Clark and Heskin (1982) found that rent regulation has a significant impact on mobility in Los Angeles where vacated units were deregulated at the landlord's request. In Ontario, where there is no vacancy decontrol provision, the Ministry of Municipal Affairs and Housing (1980) found that mobility had not changed noticeably between 1978 and 1980. Miron and Cullingworth suggest that the effect of rent regulation on mobility depends upon the stringency of the regulatory system:

> Much depends on the level of rents. Where rents have been frozen for a long period at what is usually a very low level, there is a presumption that the argument has some validity. It has far less where rents are 'controlled' but not frozen. (1983, p. 47)

It should be pointed out that reduced tenant movement does not necessarily imply either reduced mobility or policy failure. Tenant movement is only an approximation for mobility which is contingent upon factors such as changing job opportunities and household size. It follows that a reduction in movement may be, in part, a result of improved security of tenure or affordability (Ontario-MOMAH, 1982).

Arnott argues that the rationing mechanisms promoted by excess demand produce an inefficient matching of households to housing units. For instance, a middle income household that would unwillingly pay the market-clearing rent for a medium-sized, medium-quality apartment may, in a regulated market, have to choose between a large, low-quality regulated unit and a small, high-quality unregulated one.

No data for Ontario was found to support the above argument. However, in a study on rent regulation in New York City, De Salvo (1971) states that:

> Tenants of controlled housing consume neither substantially more nor substantially less housing than similar families in uncontrolled housing: the principal difference is that controlled tenants pay considerably less than the market value for the housing they consume. (p. 227)

2.8 Regulated Tenancies and Other Housing

Achtenberg (1973), Arnott (1981) and Blatt (1982) believe that redistribution may take place between tenants of regulated units and other housing consumers. Homeowners, in particular, may be affected by changes in housing demand and property taxes.

Arnott and Blatt, in discussing the case where there is excess demand for regulated units, outline the following possibilities:

1. Excess demand may spill over into the owner-occupied housing market and thus drive up the prices of homes. This would represent a gain for existing homeowners through increased property values.
2. Similarly, reduced investment in rental construction may result in rental shortages forcing tenants into the ownership market.
3. Tenants may use savings gained through reduced rents, to make down payments on homes.
4. Alternately, some households will stay in the rental market for a longer period due to the lower rents.

Because these factors tend to be offsetting the overall effect is uncertain. Nor were any empirical studies found which attempted to measure these effects. Blatt states:

> In reality, there are so many other factors entering these equations that a whole study could be devoted to the purchase decision.

> Some of these factors are: the change in demographics, the increasing number of two-earner households, the rise in interest rates and the expectations regarding continuing tenant protections. (1982, p. 38)

Ontario-MOMAH suggests two possible causes for increased property taxes on homes and commercial properties. Ontario-MOMAH (1981) maintains that in jurisdictions other than Ontario, tax collections from rental buildings have fallen either because:

1. Assessments of property value are based on market values which are reduced by rent regulation; or
2. Assessments are based on physical condition which has deteriorated as landlords cut back on maintenance expenditures.

Other things being equal, if the government wants to collect the same total property tax revenue, it would be necessary to raise the overall tax rate in the event of reduced rental property values. This tax base shifting would partially offset landlord losses at the expense of other housing consumers as well as possibly affecting commercial and industrial property tax rates.

However, Ontario-MOMAH argues that it is unlikely that such a shifting of the tax base has occurred to any great extent in Ontario. The Ministry notes that the Province does not employ a full market value assessment system in most areas and that serious physical deterioration has not occurred. Furthermore, the Ministry maintains that rental property is generally over-assessed relative to ownership property.

Ontario-MOMAH also presents estimates of property tax losses of $32 million for 1980. The Ministry does not attribute these losses (at the municipal level) to tax shifting, but rather, to the total stock of rental housing which is thought to be 40,000 units less than what it would have been in the absence of rent regulation.

Eckert (1983) and Sternlieb and Hughes (1979), on studying various American jurisdictions, found evidence to suggest that tax-burden shifting had occurred under rent regulation.(12) Gilderbloom (1983), however, found no evidence of tax-burden shifting in New Jersey.

2.9 Public Costs

Smith and Tomlinson (1981) and Ontario-MOMAH (1982) provide estimates of the public costs of rent regulation in Ontario. These costs consist of lost government revenue (tax losses -- capital gains and property taxes) and administration expenses as well as the operation costs of any programs introduced to stimulate the supply of rental housing.

Smith and Tomlinson estimated that the cost of rent regulation in Ontario in terms of lost revenue to the three levels of government was in the order of $175 million in 1980. Included in this estimate were tax concessions under the federal government program (MURB), reduced provincial and municipal tax revenues due to the reduced value and income of rental buildings, lost municipal tax revenue due to reduced rental construction, lost revenue due to unemployment in the construction industry, and the cost of administering the rent regulation program. They have estimated that if rent regulation continues, the annual tax loss and government cost in Ontario will rise to $450 million by 1985.

Ontario-MOMAH, while agreeing with the basic assignment of costs by Smith and Tomlinson, provide an overall estimate of $99.9 million for all three levels of government in 1980.

These cost estimates calculated for rent regulation suggest that rent regulation may have a far greater impact on government budgets than the direct expenditures for the Residential Tenancy Commission (the direct costs of administering the rent regulation program was about $7.4 million for 1984-1985).

2.10 Summary

The principal conclusions as attributed to the various studies include:

1. Rent review by definition does not produce a result that provides equal benefit or costs to those of similar incomes regardless of their tenure choice or choice of investment. The standard criteria of horizontal equity is, therefore necessarily violated by such a program considered by itself. (Ontario-MOMAH, 1983, p. 130)
2. The principal reason that the horizontal equity criterion is not met, is because benefits are

assigned by rental units rather than by household income and composition. (Achtenberg, 1973)

3. Rent review is vertically equitable but only to a modest degree. (Blatt (1982) and Miron and Cullingworth (1983))

The distributive effects of rent regulation in Ontario are summed up by Ontario-MOMAH (1982):

> 1. About 1/3 to 2/5 of households with low and moderate incomes benefit from the program, while a smaller per cent of higher income groups benefit;
> 2. Benefits and net transfers are a higher share of income for lower income classes;
> 3. About 3/4 of the cost in terms of rent reduction is borne by the top 60 per cent of households in term of income distribution.
> 4. Over one-half of the total benefit goes to the two richest household groups [which make up about 48 per cent of renter households];
> 5. Among renters the average benefit tends to increase with income;
> 6. The cost of the redistribution is borne by a small proportion of the population implying substantial costs for landlords and no direct cost to other people with equal income levels. (p. 132)

Several papers indicate areas where additional statistics and further research may help to better assess the distributive effects of rent regulation. According to Miron and Cullingworth (1983):

1. There is a need for more complete data concerning landlords, including the degree of foreign and corporate ownership.
2. A better empirical understanding of indirect effects such as building maintenance reduction would be useful.

Slack and Amborski (1984) suggest the following:

3. Further research into the existence and nature of imperfections in the rental market including estimates for regional markets.
4. Measurements of the extent and nature of non-price rationing.
5. Better estimates of supply responses to changes in demand and the resultant impact on rental starts.
6. Setting the effects of rent regulation within the broader context of other housing programs and income security programs.

Notes to Section 2

(1) A considerable amount of literature exists on this topic. See, for example, Behn (1981) for a discussion of the trade-offs between efficiency and equity. Stanbury (1984) provides further discussion and references.

(2) Objectives of rent regulations are described throughout the review. These may include improving security of tenure by limiting economic evictions and curtailing excessive rent increases.

(3) Blatt's estimate of 7.5 per cent is based on a formula which incorporates low vacancy rates. See (Blatt 1982, 18).

(4) Smith and Tomlinson (1981) compare CMHC statistics for 1 bedroom apartments in the City of Toronto to the Consumer Price Index.

(5) One per cent was chosen for illustrative purposes. The authors note that they could just as well have chosen 5 or 10 per cent.

(6) The use of income to indicate ability to pay for housing is outlined in Section 3.

(7) The loss in capital value results because the present value of a rental property is the appropriately discounted future stream of income minus the salvage value of the property. This loss may be realized upon sale of the property.

(8) Under Ontario's present rent regulation system, landlords are allowed to claim the cost of hiring rent review experts as an operating expense. See Rent Review Guidelines, by The Residential Tenancy Commission.

(9) The number of applications for rent increases above Ontario's 6 per cent limit rose dramatically in the early 1980s when inflation was at historically high levels. See the Annual Reports of The Residential Tenancy Commission for details.

(10) If regulated units are in short supply, groups most affected might include, newly formed households and thus younger tenants, immigrants and those who were forced to move because of changes in employment, family size or affordability.

(11) Higher rents in the unregulated sector may occur if developers or landlords of new, exempt buildings believe that rent regulation may be extended to cover the exempt sector. Thus, a risk premium is demanded in the form of higher rents.
Two recent studies examining this aspect (Fallis

and Smith, 1984a; 1984b) are reviewed in Section 1 (subsection 1.2.1).

(12) A discussion of the empirical difficulties linked to these studies is outlined in Barr (1983) and Weitzman (1983).

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SECTION 3: RENTAL HOUSING AFFORDABILITY

3.1 Introduction

> No issue in housing policy is more baffling than that of "affordability" -- the gap between effective demand and need. Difficulties arise both with concepts and with data... (Cullingworth 1980, p. 22).

The objective of this section is to provide a comprehensive but by no means exhaustive, summary of the analysis of housing affordability. It begins with a brief Canadian historical outline citing several early sources found in a study by The Canadian Council on Social Development (1977). The main body of the review concentrates on recent empirical findings that address the issue of rental affordability in Canada, particularly Ontario.

The data are organized by issue and method of analysis with critical comments found in the literature so the reader can evaluate or select studies that may be of interest. A summary table of affordability estimates is provided in Appendix 3A for easy comparison.

3.2 Historical Perspective

In Canada the lack of affordable housing has been a longstanding concern. As early as 1919, it was observed that "the high price of building land and building material have made it impossible for the worker to provide himself with a home, and some means should be adopted, with as little delay as possible, to remedy this defect" (Justice Mathers, 1919, p. 13).

In 1935, the availability of affordable housing was again observed to be a problem. A Special Parliamentary Committee on Housing urged that "the information, institution and pursuit of a policy of adequate housing should be accepted as a social responsibility" (Advisory Committee on Reconstruction, Housing and Community Planning, 1944, p. 34). The Committee concluded that "there is no apparent prospect of the low-rental housing need being met through unaided private enterprise building for profit" (Ibid., p. 34).

In The Vertical Mosaic (1965), Porter states that the post-war federal government decided that family allowances and home-ownership loans constituted a suitable housing program. By including family allowances, the government appeared to recognize the possibility that affordability problems could be, in part, due to income deficiencies rather than a shortage of available, adequate housing. This argument is raised in several papers. At this point, it may suffice to note that any program that attempts to alleviate overall hardship will also reduce housing affordability problems. Welfare and unemployment benefits are two such programs.

According to Patterson (1977), housing policy in the 1950s was primarily concerned with assisting home ownership, while assistance to the low income tenant household was the major concern of the 1960s. The year 1964 was a 'water-shed' because it was then that the National Housing Act was amended to enable the Central Mortgage and Housing Corporation (CMHC)(1) to lend money to provincial and municipal housing agencies. Those bodies, in turn, used the allotted funds to construct or acquire rent-geared-to-income housing and public housing:

> Partly as a result of these legislative changes, combined with the "war on poverty" initiated by Prime Minister Pearson and a desire on the part of the provinces to invest in owned residential real estate, national housing policy became almost totally orientated towards providing mortgages for social housing. (1977, p. 294)

Smith (1983) comments that by the end of the 1960s Canada was extremely well housed:

> Canada ranked first in the Western world in terms of number of rooms per dwelling, was tied for first with the United States for lowest occupancy and crowding densities and was second to the United States in the provision of basic facilities. (p. 2)

While housing quality continued to improve during the 1970s, increased financing and construction costs, among other things, began to force down residential starts across North America. Smith comments that "it was clear to some observers that a 'cost-expense-rent squeeze' was looming and that a sharp reduction in private multiple rental starts was likely unless rents were to rise substantially" (p. 3).

In 1973, the Honourable Ronald Basford, then the federal minister responsible for housing affirmed that:

> It is the fundamental right of every Canadian to have access to good housing at a price he can afford. Housing is not simply an economic commodity that can be bought and sold according to the vagaries of the market, but a

> social right. (House of Commons, Debates, 1973, p. 2257)

By 1980, combined federal and provincial annual expenditures on assisted rental housing ran about 250 million dollars.(2)

Despite such statements and fiscal commitments, several empirical studies have observed continuing affordability problems in the rental sector. Most authors would agree that there are difficulties; however, the incidence and degree of hardship vary with both time and place as well as with the data and method of analysis.

3.3 Traditional Indicators of Housing Problems

Burke et al. (1981) and Cullingworth (1980) state that there have traditionally been three measures of housing need: physical inadequacy, crowding and excessive shelter-to-income ratios. The authors contend that each indicator considered by itself has several weaknesses, which are outlined below.

The capability of such indicators to distinguish between affordability problems which result from insufficient income and those related to the lack of adequate, reasonably priced housing is noted throughout the discussion and summarized in subsection 3.6.

3.3.1 Physical Inadequacy

Physical inadequacy pertains to the structural condition of housing:

> These standards have usually been derived from considerations such as unsafe or unsanitary dwellings, including the presence of adequate plumbing, heating and other basic facilities. (Burke, 1981, p. 5)

Using Statistics Canada's Household Income, Facilities and Equipment Survey (HIFE),(3) the Bureau of Municipal Research (1977) found that in 1972 about 3 per cent of Metro Toronto's housing stock lacked basic facilities.

Citing the HIFE data Steele and Miron (1984) say that:

> For 1976 in Ontario the estimated incidence of no running water among poor and near-poor households is 13 per cent in rural areas as against less than 1 per cent in large areas where it is illegal; and the incidence of no central heating is 28 per cent in rural areas, as against under 2 per cent in large urban areas. (p. 35)

The Ontario Ministry of Municipal Affairs and Housing (Ontario-MOMAH, 1982) reports that in 1979, 99.6 per cent of Ontario's dwellings had running water, 99.3 per cent had a bath or shower, 99.1 per cent had flush toilets and 99.6 per cent had refrigeration.(4)

CMHC (1983) observed that the nation-wide incidence of physically inadequate rental dwellings declined from 1.9 per cent in 1976 to 1 per cent in 1980.

Cullingworth (1980) concludes that "Canadian housing is generally of high quality, and the traditional measures of inadequacy (largely related to plumbing and heating) are no longer 'sensitive'" (p. 12).

Housing surveys provide another way to estimate physical inadequacy by attempting to measure directly the number of rental units which are in poor condition. CMHC's Survey of Housing Units estimated the incidence of poor quality housing for nine Ontario cities. Kitchener had the lowest incidence of rental housing in poor condition at 4 per cent. Sudbury had the most at 15 per cent. For Toronto the estimate was 5 per cent.(5)

The 1981 Census also provides figures on dwelling conditions by asking tenants whether their buildings needed regular maintenance, minor or major repairs. About 7 per cent of Ontario's tenant households reported that major repairs were needed -- another 17 per cent believed that minor repairs were necessary. However, the incidence of needed repairs did not bear a significant relationship to monthly rents and varied little among the province's major cities.

Housing researchers encounter several limitations in using these estimates of the number of physically inadequate dwellings:

1. Most surveys do not collect data pertaining to the quality of housing. For example, although the 1974 Survey of Housing Units gathered information on the exterior of dwellings, it did not ask (apart from plumbing) about interior conditions.
2. Different surveys use different criteria and assessment techniques.
3. Some households may be able to afford adequate housing but prefer to live in inadequate housing for various reasons.

4. Definitions of adequacy may be at variance with the attitudes of some people.

Cullingworth (1980) comments that the difficulty in choosing what is adequate is empirical rather than conceptual. He adds that the relevant housing standard to take is that which is appropriate with respect to both time and place. Burke et al. (1981) state that, historically, the judgement as to what constitutes adequate housing has risen in response to greater per capita incomes and consumer expectations.

Marks (1984) believes that:

> Quality of housing, broadly defined, is at the heart of the issue of affordability, despite the tendency to think of affordability as dependent on a household's income (or wealth) and thus its ability to pay for housing or the production costs for housing. An assessment of the affordability of housing always assumes, at least theoretically, that only housing of some minimum quality is allowable. (p. 12)

Affordability measures which incorporate estimates of quality are outlined in subsection 3.4.

3.3.2 Crowding

Several studies define crowding, for measurement purposes, as more than one person per room.(6) Burke et al. (1981) estimate that 4 per cent of urban Canadian households lived in overcrowded conditions in 1974. CMHC (1983) found that among tenant households, crowding, like physical inadequacy, declined between 1976 and 1980 from 3.4 per cent to 1.9 per cent.

The census provides somewhat higher figures for 1981 -- between 2 and 3 per cent of the province's tenant households reported having more than one person per major room. However, it was found that tenant households earning between $20,000-$25,000 had the highest incidence of crowding -- those earning between $5,000-$10,000 the lowest.(7)

As with the physical inadequacy indicator, the crowding indicator by itself suffers from several limitations:

1. The figures do not distinguish between those who voluntarily choose to live in crowded conditions and those who do so for economic reasons.
2. Definitions of crowding may not conform to individual family perceptions.

Some possible reasons, other than increased affordability, are suggested for the reduction in crowding and inadequacy:

1. Greater desire for privacy. People may be willing to spend a high proportion of their income on housing in order to maintain separate dwellings.(8)
2. Zoning by-laws, building codes and health and safety standards may impose better standards.

Marcuse (1978), Marks (1984), and Steele and Miron (1984) discuss the possibility that quality standards may impose hardship on low income households who may want less quality at lower prices. Marcuse, in discussing the American housing situation, says:

> Housing codes and the imposition of standards of quality on landlords and builders might be viewed as economically redistributive. They are so only if coupled with rent controls or other limits on the pass-through of costs. Absent such limits, higher standards simply result in higher rents or housing costs; low-income families might in fact prefer poorer housing at lower costs. (1978, p. 22)

Steele and Miron reason that the higher incidence of households who lacked basic facilities in rural areas where such facilities were not mandatory indicates that low income households may prefer less 'quality' than present building standards dictate:(9)

> There should be serious reconsideration of current building codes and housing standards. In particular, there is a good case for varying these standards by neighbourhood, just as zoning rules differ by neighbourhood; some variation may already exist because of different levels of enforcement. (Steele and Miron, 1984, p. 76)

Cullingworth concludes:

> This transformation of the housing scene might be summarized as 'much more and much better housing'. This may seem platitudinous, but there are some aspects (and implications) which are both not so obvious and also of crucial importance. First, the higher standards are most costly, and on this account alone one could expect that housing expenditures would rise. (1980, p. 6)

3.3.3 Rent-to-Income Ratios

The simplest and perhaps most common measure of rental affordability is the rent-to-income ratio. Rent is divided by household pre-tax income to estimate the percentage of income that is spent on shelter.

Traditionally, 25 per cent, and more recently 30 per cent, 'thresholds' (where utilities are included in rental payments) have been considered indicative of housing need.(10) That is, those paying more than the threshold have been classified as suffering hardship.

In its extensive review of the Canadian housing situation, the Canadian Council on Social Development (1977) reports that "Canada may be going backwards in making housing more affordable" (p. 23). It notes that between 1969 and 1972 the proportion of income spent by families on shelter increased for each of the five income brackets. The Council states that according to 1971 national census data, there were over a million tenant households spending more than 25 per cent of their incomes on housing. Moreover, 62 per cent of those with affordability problems spent over 35 per cent of their incomes on rent.

Burke et al. (1981) used the 1974 CMHC Survey of Housing Units(11) as a data base, to provide information on unsubsidized tenants in metropolitan areas. Households with annual incomes below $1,500, as well as households whose annual rents exceeded reported annual incomes, were excluded.(12)

Burke et al. found that 28 per cent of the urban Canadian tenant households surveyed were over the 25 per cent threshold. This figure compared favourably with the United States, where 39 per cent of tenant families were reported to be in need. In both countries the incidence of hardship was noticeably higher for tenants than for homeowners, either with or without mortgages.

CMHC (1983) provides more recent estimates. Using HIFE data, they estimate that 24 per cent of Canadian tenant households were over the 25 per cent threshold in 1980. This represents a significant drop of more than 10 per cent over the 1974 findings.

However, it is not known how much of this improvement can be attributed to differences in the data bases. CMHC observed that tenant households in the 30 per cent threshold increased between 1976 and 1980, suggesting the situation was worsening. In 1980, by the 30 per cent criterion, Ontario tenants had a slightly higher incidence of affordability problems than the country as a whole -- 22.2 per cent compared to 21.6 per cent.

Miron and Cullingworth (1983) undertook an extensive study of the affordability of rental housing in Ontario, using the HIFE data base. Although they express doubts about the use of rent-to-income ratios, they say that:

> If one adopts the 25 per cent threshold, the number of problem households in Ontario is substantial. In 1978, there were about 242,000 problem households: roughly the total number of households in the City of Toronto ... about one in every three renter households in Ontario is spending in excess of 25 per cent of their income on rent. (p. 106)

The authors also calculate a measure of the magnitude of the rental housing problem. They estimate that in 1978 in Ontario alone, hardship households spent $275 million above the 25 per cent limit. For the average problem household, the gap between what was spent and the 25 per cent threshold amounted to $100 a month out of a typical problem household's monthly income of $560. Thus, the average problem household was estimated to be spending approximately 43 per cent of its income on rent.

Miron and Cullingworth note that the incidence of affordability problems fell after the introduction of rent regulation (i.e. 1976-1978). They reason that "while there may be other explanations for this change, it is consistent with the arguments that rent review has benefitted problem households" (p. 107).

However, the 1978 HIFE survey reclassified households that received support from relatives as subsidized:

> Indeed, if one assumed that the incidence of problems was higher among those receiving assistance from relatives or if the average size of their problem was higher than assumed here, the 1978 figures could have shown a clear increase in the affordability gap. (Ontario-MOMAH, 1982, p. 117)

In studying the need for rental housing in the City of Toronto, the Bureau of Municipal Research (1977) employed a 30 per cent threshold as a criterion of need. Using the CMHC, 1976, Apartment Vacancy Survey and census incomes, the Bureau found that over a quarter of the city's tenant households were in need:

> Over 1/4 of tenant households would be pressed to pay the going market rent for even a bachelor apartment and over 2/3 could not pay the rent for a 3-bedroom unit without spending more than 30 per cent of their gross income. (p. 32)

Yet, the authors note these figures represent general estimates and are not very satisfactory for planning purposes as the incidence of need may be overstated. That is because the study did not use individual household incomes and rents. Rather, their estimates are based on averages of grouped data with no adjustment for the actual distribution of rents within the income groups.

Ontario-MOMAH (1982a) cites rent-to-income ratios from their 1980 Rental Market Survey. Seven metropolitan areas were surveyed on housing costs, incomes and household characteristics. The Ministry reports that approximately one-third of all respondents were over the 25 per cent threshold while just under one-fifth were over the 30 per cent mark. Considerable variation was found among cities. London had the greatest incidence at 34 and 19 per cent for the 25 and 30 per cent thresholds. Sudbury registered the lowest at 24 and 12 per cent respectively; the figures for Metro Toronto were 31 and 17 per cent.

The Social Planning Council of Oshawa and Whitby (1981) provides further regional comparisons. In Durham, a region to the east of Toronto, in 1976, 30 per cent of tenants were over the 25 per cent threshold and 11 per cent were above the 40 per cent threshold. This study also cited 1974 CMHC 25 per cent threshold estimates for Ottawa (33 per cent), Hamilton (34 per cent) and London (37 per cent). The Council forecast that in 1983 and again in 1993 the incidence of Durham tenants surpassing the 25 per cent threshold would amount to 57 per cent. That is, a majority of tenants would be in need.

Limitations of the Rent-to-Income Ratio

As previously noted, there are several shortcomings associated with the rent-to-income approach. Burke et al. (1981) believe that this ratio is a reasonably clear measure of financial burden. Nevertheless, they are in agreement with Cullingworth (1980) as to this indicator's inherent limitations. Some of these are:

1. Rent-to-income ratios fail to reflect overall housing need since they do not take into account dwelling conditions. Housing services may be 'underconsumed' in order to lessen housing expenditures.
2. Estimates include households that voluntarily pay a high percentage of their incomes to obtain housing services that are above minimum standards. This practice is sometimes referred to as 'voluntary overconsumption'.

However, Miron and Cullingworth found that crude indicators of overhousing and underhousing among tenants do not appear to be related to the incidence of problem households.

3. Current, rather than permanent, income or wealth is not indicative of long-term household budgeting. For example, some households may experience temporary hardship through illness or unemployment.

Young families may spend a considerable share of their present income on accommodation, expecting their wages to increase and thereby lower their relative expenditures in the future. On the other hand, the elderly may rely on savings which were set aside to compensate for income losses due to retirement. As a consequence, rent-to-income estimates may change over time because of demographic trends which are erroneously attributed to changes in affordability.(13)

4. Similarly, because rent-to-income ratios are not precise, Stegman (1982) reasons that increases in these ratios can reflect "the loss of higher-income families to the homeownership market, a disproportionately high rate of growth in traditionally poor socio-economic groups, ... substantial rent inflation, or combination of the above" (p. 156).

For Canada, Smith (1983) believes that "the increase in the rent-to-income ratio is likely to be simply a reflection of the decline in tenant incomes associated with the falling average age of tenants and shift of higher income tenants to homeownership" (p. 23).

According to Miron (1984) the sharp increase in people living alone implies an increase in the typical ratio of shelter expense to income as one-person households commonly have lower incomes than multi-person households have but their shelter expenses are not proportionately smaller. A countering factor cited by

Miron (1984) and Patterson (1977) has been the increase in multiple earner households.

5. Rent-to-income thresholds are arbitrary in that they are based on the researcher's judgement as to which ratios indicate need. Further, different household compositions (by age, size) and locations may require different thresholds:

> Should the same ratio be used for all households? Should the ratio vary for different income groups? Should different households have different ratios? For example, should singles be allotted a higher ratio than large families? (Miron, 1984, p. 5.8)

Miron concludes that these are normative questions and no simple answer presents itself. Estimating rent-to-income ratios which vary with all relevant household characteristics would be a considerable task and perhaps beyond the scope of most currently available data. Rent-to-income ratios which vary with household size are discussed in subsection 3.4.1.

3.4 Alternative Measurement Approaches

Burke et al. (1981), Cullingworth (1980), Marks (1984), and Miron and Steele (1984), all dissatisfied with the application of shelter ratios, provide more refined methods of estimating affordability problems. Burke et al. and Cullingworth believe that the traditional indicators -- shelter ratios, crowding and physical adequacy -- by themselves, offer poor estimates of housing hardship. Still, they note that any measure of affordability must take into account some concept of shelter adequacy as well as rents and incomes.

3.4.1 Rent-to-Income Scales

One suggested way to improve on the rent-to-income indicator is to vary the ratio with household size and income. CMHC employs such a scale in determining rents for geared-to-income housing. Ratios range from 17.5 to 25 per cent, depending on household size and income.(14)

Steele and Miron (1984) provide estimates using ratios scaled to household size ranging from 40 per cent for one person households to 20 per cent for five or more person households. They also employ the 1982 Statistics Canada low income cut-off to refine the HIFE data.(15) For those earning less than twice the cut-off they found that fewer Ontario tenant households had affordability problems in 1982 than in 1976 -- declining from 182,000 households to 122,000 households for large urban centers. For smaller urban centers and rural areas affordability problems increased slightly.

Fallis (1984) and Marks (1984) provide further ways in which rent-to-income ratios might be scaled:

1. The 25 per cent rule should be tied to the relative price of housing.(16) If the relative price of housing falls the ratio should also fall.
2. Rent-to-income ratios should be scaled by location in order to reflect different trade-offs between housing consumption and commuting costs.
3. Ratios should be scaled by households' age

composition to reflect different needs and life cycle patterns of spending and saving.(17)

3.4.2 The Core Need Approach

An alternate affordability measure to the rent-to-income ratio is the core need approach. Burke et al. (1981) determine core need by combining the three traditional indicators in a two-step process so as to identify genuinely needy households. Such households are either those who live in physically inadequate or over-crowded dwellings because of insufficient income or those who spend more than 25 per cent of their income in order to maintain minimally acceptable housing.

The first step is to estimate the number of households currently experiencing housing problems according to the 25 per cent rent-to-income ratio. The second step is to eliminate those who do so voluntarily. This is done by calculating average rents for standard (adequate) units. Those who can afford standard housing without going over the 25 per cent limit are deleted from the estimates. Third, those who spend less than 25 per cent, but do so only by living in inadequate housing are added to the count. This approach tends to reduce the incidence of need by 10 to 20 per cent.

Burke et al., employing the 1974 Survey of Housing Units, estimate that, nationally, 24 per cent of urban tenant households had core need problems. This is a 14 per cent reduction in the incidence of hardship compared to the 25 per cent rent-to-income calculation:

> Traditional measures tend to portray the magnitude of housing problems inaccurately. The core need measure is more precise and shows that even though real housing need may be lower than previously thought, the magnitude of need is still large enough to be of major concern. (Burke et al., 1981, p. 27)

Marks (1984) notes that:

> While this approach does use the 25 per cent rule, it acknowledges that problems of affordability can result either from having to spend too much for adequate housing or from having too little housing when the household spends a reasonable proportion of income -- essentially two sides of the same question. (p. 12)

CMHC continues to employ the core need approach but it uses the 30 per cent threshold for most estimates, making comparisons with the estimates of Burke et al. difficult. CMHC (1983) reports that, nationally, 18.3 per cent of tenant households had core need problems in 1980. The figure for Ontario was slightly lower at 17.8 per cent.

While CMHC believes that the core need concept is an improvement on the traditional measures of housing problems, it presents three limitations:

1. A rent-to-income ratio must be specified. Thus, this indicator involves an "essentially arbitrary" choice.
2. Income requirements for other essentials vary by household size and age structure. These are not considered in formulating the core need approach.
3. As with other studies and methods, CMHC figures are based on sample data. Due to the limited sample

> size of the HIFE Survey, CMHC believes that it is not possible to fully account for intra-regional variations in rental housing costs. (1983, pp. 39-40)

Marks (1984) and Miron (1984) discuss a further difficulty inherent in this approach. They argue that the definitions of 'standard' housing based on physical adequacy and lack of crowding influence the calculations of average rents as well as the portion of households who are not properly housed.

3.4.3 The Budget Approach

Another alternative method, the budget approach, is outlined by Cullingworth (1980), Marks (1984) and Miron (1984). This method involves the determination of expenditures for non-housing necessities such as food, clothing, furniture, transportation etc. The remainder is what the household can afford to spend on housing.

Fallis (1984) contends that this logic is implicit in the concept of affordability and that rent-to-income ratios are used as proxies:

> If a lower-income household spends more than 25 per cent of its income on housing, then there will not be enough money left over to buy sufficient foods, clothing, transportation, recreation, medical care, education and so on. (p. 26)

One important difference between the budget approach and other methods is that budgetary measures consider the specific needs of different household types. For example, the Social Planning Council of

Metro Toronto's "Guides for Family Budgeting" (1983) presents several budgets based on family size and composition.

The Bureau of Municipal Research (1977) constructed estimates for the City of Toronto, using the Social Planning Council of Metropolitan Toronto's Guidelines for Family Budgeting (1976), from 1971 census incomes and CMHC survey rents. It made two estimates -- the first was based on 'low end' rents; the second utilized average market rents. The Bureau found that between 18 and 22 per cent of Metro tenants had affordability problems. Although differences in time and location make comparisons difficult, these estimates are similar to the core need estimates cited in subsection 3.5. Both sets of estimates represent significant reductions on the rent-to-income estimates.

The Metropolitan Toronto Planning Department (1980) applied the budget approach to Metro Toronto. The Department found that just over 18 per cent of the households could not afford their rents in 1980. This figure was reduced to 12 per cent after those served by public housing were eliminated from the count.

While the budgetary estimates are low in comparison to rent-to-income estimates, it should be noted that neither budgetary study takes into account the distribution of rents by incomes and may therefore tend to understate tenant hardship.

The budget approach automatically places the greatest need among the low income groups. After subtracting an appropriate amount for other necessities of life, low income groups will not have enough left to pay for adequate housing. Thus, this approach excludes some families who cannot find adequate housing at a reasonable cost and includes those who are renting at 'bargain' rates. Cullingworth (1980) qualifies the use of the budget approach by saying:

> In Ontario, a standard reference point is the Social Planning Council's Guide for Family Budgeting. These contain sample budgets (which include housing, though it is stressed that housing costs are so variable that it is advisable, in using the guides, "to accept the actual cost of shelter in place of a budget estimate". (p. 16)

While rent-to-income ratios are often criticized, this is one shortcoming that is not associated with their use if data on individual household incomes and rents are available.

In perhaps the strongest criticism of the budget approach, Ontario-MOMAH (1982) says that:

> As such, the budgeting method measures more than the housing affordability gap -- it measures the total shortfall of income required for all purposes. It would therefore, seem to be an overstatement of the degree to which housing costs produce financial difficulty. Indeed, if the expenditure for other goods and services equalled the household's income, this measure would indicate that the housing affordability gap would be equal to the entire amount of the housing expenditure. (p. 108)

The Ministry concludes that "these problems would seem to argue against the use of a budgeting approach in defining of housing need" (p. 108).

Miron (1984), on the other hand, believes that the budget approach is a good example of how a family's overall needs might be estimated, and gives a baseline from which researchers can begin to assess housing affordability.

3.4.4 Ability-to-Afford Measures

In formulating alternate ability-to-afford measures, Miron (1984) employs the 1978 Family Expenditure Survey which has the advantage of allowing for:

1. Households' sources of funds other than annual income. These include inheritance, insurance settlements as well as the depletion of savings or the accumulation of debts.
2. Detailed housing expenditures such as property taxes, insurance, maintenance costs and utility expenditures. However, these are more important in considering homeownership than renting as these expenses are usually included in rents.
3. Accommodation changes during the period (from tenant to owner or vice versa).

Miron approximates both permanent income and 'sources of funds' estimates.(18) These, he argues, may be better estimators of ability-to-afford than annual income. The author compares these three indicators using various rent-to-ability-to-afford thresholds. Using the 25 per cent rent-to-income threshold, the author found that in 1978 roughly 29 per cent of tenants had affordability problems nationally. This figure declined slightly when the rent-to-source of funds ratio was used but rose to 42 per cent when the rent-to-permanent income ratio was employed. For the latter, the number of tenants over the 25 per cent threshold declined for low income groups but increased dramatically for high income earners. The incidence of affordability problems for Canadian tenants earning over $25,000 was 1.3 per cent using the rent-to-income ratio but rose to 41.5 per cent using the rent-to-permanent income ratio. Miron attributes some of this difference "to peculiarities in the method" of estimating permanent income. This suggests that the permanent income measure, as formulated, may not be a suitable measure of affordability.

Miron found another significant difference among the ability-to-afford measures. About 60 per cent of tenants who earned less than $5,000 in 1978, spent in excess of 35 per cent of their income on shelter. However, based on the alternative measures of ability-to-afford, the incidence was much smaller -- from 41 to 48 per cent. Miron reasons that some tenants were experiencing atypically low incomes -- possibly resulting from temporary unemployment. Again, the methodology might account for part of this difference.

3.5 Specific Groups In Need

Throughout the papers reviewed, specific groups are cited as suffering disproportionately high incidences of affordability problems:

> This affordability problem arises mainly among elderly households, lone parent households, households without income earners, and persons

> living alone. (Miron and Cullingworth, 1983, p. 131)

CMHC (1983) tends to support this observation:

> To summarize, housing problems have not disappeared. With one-fifth of renter households in the country paying what is considered to be a disproportionate amount of their incomes for rent, the need for some form of assistance is evident. This is particularly the case for senior citizens and women and for those in the lowest income quintile with the least amount of disposable income. (p. 44)

The affordability problems of three groups -- low income households, the elderly and single parent households -- are discussed in some detail in the following pages.(19)

3.5.1 Low Income Households

Generally, the data from all sources reviewed below suggest that tenant households were over-represented in the lower income brackets and that this group had the highest incidence of housing need. That the average tenant's income was below the average homeowner's income is itself a possible cause but not a sufficient condition for affordability problems. The relationship between income and affordability is also discussed in subsection 3.6.

The Canadian Council on Social Development (1977) says that three-quarters of the unsubsidized households, who were paying over 25 per cent of their income on accommodations in 1971, had incomes that were below the official government poverty line. Nationally, the total number of 'poor' tenants with affordability problems was estimated to be roughly 800,000 -- more than 10 times the number of 'poor' homeowners in the same position.

Burke et al. (1981) also report that affordability problems were more common among Canadian poor. In 1974 roughly three-quarters of the lowest income quintile (fifth) spent more than 25 per cent of their income on shelter. The figure increased to 85 per cent when the core need approach was employed. The higher incidence registered by the core need approach reflects the addition of low income households that paid less than 25 per cent but did so only through crowding or by occupying substandard dwellings.

For the second lowest income quintile, the incidence of core need problems was lower--16 per cent. This figure was half as great as the estimated percentage when shelter-to-income ratios were employed. The reduction implies that half of those households deemed in need by the ratio method had voluntarily placed themselves in such a position or were unable to find inexpensive rental units or both. The two causes were not differentiated.

Miron and Cullingworth (1983) observed a similar pattern for Ontario in 1978. Problem households' incomes averaged $6,700 per year. Almost all of these households were below the province's median household income and nearly half were below Statistics Canada Revised Low Income Cutoff level.

In the Durham region, the Social Planning Council of Oshawa-Whitby (1981) reported that in 1976 almost 70 per cent of tenant households earning under $10,000 were over the 25 per cent threshold and 45 per cent were over the 40 per cent threshold. They also found that the incidence of affordability problems was less significant for homeowners in the same income bracket.(20)

As stated earlier, the budget approach inherently places the incidence of need on the low income groups. Thus, studies which employ this method do not give incidence percentages. Instead, they offer estimates of income floors below which households are considered in need.

The physical condition of rental units, occupied by low income tenants, is not easily determined as quality measurements tend to be subjective or excluded from data.

A study undertaken by the Metropolitan Toronto Social Planning Council (1974) found that among 95 per cent of tenant households living on some form of social assistance, only 27 per cent lived in good housing while 44 per cent lived in substandard units. This contrasts with the Survey of Housing Units, 1974 data. As Miron and Cullingworth note of this survey, "while the proportion of 'poor' housing in Toronto is 4.7 per cent, the proportion of the highest income group ($22,500+) living in poor housing was actually 4.8 per cent" (1983, p. 96). However, this survey only took account of plumbing and exterior conditions.

3.5.2 The Elderly

In most studies, the elderly were identified as the age group which incurred the highest incidence of affordability problems. The Canadian Council on Social Development (1977) observed that, nationally, about half the elderly couples and over four-fifths the elderly individual tenants were over the 25 per cent threshold in 1971. According to Statistics Canada, 1972, Urban Family Expenditures on Shelter and Household Durables Survey, the Council says that while under one-fifth of Canada's population was classified as poor (by Statistics Canada Unrevised Poverty Lines), over half of the single persons, 65 and over, were deemed to be poor. Among poor elderly tenants, 88 per cent spent more than 25 per cent of their incomes on rent.

For unsubsidized metropolitan households (both tenants and owners), Burke et al. (1981) also found that the incidence of hardship was significantly higher for households whose heads were 60 years of age and older. Approximately 37 per cent of this group spent more than a quarter of their income on shelter even though some homeowners in this group did not have mortgages. By the core need approach 33 per cent were in need -- more than double that of any other age group.

In considering 1978 Ontario unsubsidized tenants, Miron and Cullingworth (1983) estimate that, among those 65 and older, there were 54,000 problem households or 54 per cent of that group. The authors found that, while the elderly had by far the highest incidence of need, the incidence of need among the 'poor' elderly was approximately the same as that of other 'poor' age groups.(21)

For Toronto, two studies provide a comparison of housing for the elderly and the effects of government programs. The Bureau of Municipal Research (1977), citing 1971 census data, stated that households whose heads were aged 65 and older received the lowest incomes. Over 37 per cent of the City's elderly heads received under $3,000 annually. Much of this group's income was government pensions. For the elderly both 1971 and 1976 median incomes were lower than for any other group. While the study did not make specific estimates of housing need by age group, the authors remark that seniors citizens are in serious need.

The Metropolitan Toronto Planning Department (1980) found that the elderly in need represented a quarter of all households that could not afford rental accommodation. However, the Planning Department states that:

> Metropolitan Toronto, through its aggressive senior citizen housing construction program in the past five years, has virtually eliminated the housing affordability problem for individuals and couples over 60 years of age. (p. 2)

Ontario-MOMAH (1982) reports that in 1980 senior citizens in Ontario continued to receive the lowest annual income of any age group. In Toronto and Sudbury almost three-quarters of the senior households were over the 25 per cent threshold. For London the incidence was lower--just under one half. For all cities except London, the portion of seniors in hardship was 2 to 3 times greater than for non-seniors.

In considering the magnitude of need among the elderly, other considerations are also cited. Miron and Cullingworth (1983) say that "one example might be an elderly couple with substantial assets who slowly use up those assets to support themselves in their retirement" (p. 111). This would be particularly indicative of those who have sold homes in order to live in maintenance-free, smaller or more affordable rental accommodations. This wealth effect, if incorporated into estimates might lower the estimates of affordability problems for the elderly.

Marks (1984) says that a household with a strong attachment to their home and neighbourhood may pay large rent increases even when more affordable housing is available elsewhere:

> This attitude may be particularly prevalent among older people who have lived in neighbourhoods for many years and have strong attachments; not surprisingly, such households are considered to have a high incidence of affordability problems. (p. 29)

In noting that the number of elderly households with affordability problems fell more substantially (1976-1982) than did the number of families with such problems, Steele and Miron (1984) comment:

> The elderly...are low-cost, immobile households, and therefore, especially likely to benefit from rent review. Thus, it is consistent with these data that rent review had some substantial effect, although other factors such as higher incomes and increased social housing for the elderly might also explain it. (p. 57)

3.5.3 Single Parent Households

Single parent households, especially mother-led families, also appear to suffer a relatively high incidence of hardship compared to other household types.

Burke, for example, found that 45 per cent of all mother-led families were over the 25 per cent threshold in 1974, 38 per cent by the core need approach. Single female households were also observed to have a disproportionately high rate of affordability problems.

Miron and Cullingworth report that in 1978, 56 per cent of single parents were over the 25 per cent limit. Here too, the possible explanation is low incomes. Almost 9 out of 10 Ontario single parent households earned less than $10,000.

3.6 Income or Housing Problems

Most studies relate similar findings; the pattern of affordability problems and income deficiencies is clearly evident throughout the literature. Still, little appears to have been done by researchers to separate the causes in order to determine whether housing market failures exist or if some incomes are simply too low in relation to the cost of affordable, adequate accommodation. Cullingworth remarks that:

> The distinction between 'housing affordability' (a housing problem) and 'income deficiency' (an income problem) may be conceptually clear, but it is difficult to devise precise (and still generally acceptable) definitions. One might argue that the problem is a housing one when those with normal incomes cannot afford normal houses, whereas it is an income one for those whose incomes

> are insufficient to obtain normal houses. This nicely solves the definitional problem by disguising it with the use of the term 'normal'. (1980, p. 2)

The difficulty appears to apply to most approaches since the link between income and affordability is not analysed in a manner that would provide conclusive evidence of the dominant causes. This may be due to the scope of available data.(22)

In discussing the difficulty in distinguishing between housing and income problems, Ontario-MOMAH (1982) says that:

> One may view the problem as primarily one of the high cost of housing, another as one of insufficient income and a third as housing cost in relation to income. The importance in viewpoint shows up in the policy focus of each of these views, with the first group focussing on housing subsidy and supply programs, the second on income redistribution policies and the third on measures directly affecting the shelter costs of households. (p. 107)

The Ministry chooses to concentrate on the third view because:

1. The issue is popularly defined in terms of housing affordability.
2. It appears unlikely that comprehensive reform to income maintenance programs will occur in the near future.
3. Any solution to income problems that ignores large variations in housing costs across the province will either be inadequate or enormously expensive.

Miron and Cullingworth reason:

> The term 'affordability' is a useful one in that it implies that the problem at issue is neither solely a housing one nor solely an income one: it is both. It is this very fact that makes the problem so difficult of solution. (1983, pp. 97-98)

On the other hand, several authors maintain that housing problems are 'more properly' referred to as income or poverty problems (Smith, 1971; Goldberg, 1983; Clayton Research Associates, 1984). Fallis (1984) appears to agree with the latter view by saying that "housing affordability is being used as a proxy to measure the inadequate consumption of other goods" (p. 27). He contends that a proper analysis should define what the social entitlements are for all commodities, including housing.(23) Moreover, he lists policy alternatives which would reduce affordability problems -- income transfers, job training programs, assistance with family budgeting, direct provision of goods, and price reductions on the various necessities.

The distinction between housing and income problems may also bear upon the choice of affordability indicator. Miron (1984) discusses the case of overhoused households who would not have an affordability problem if adequately housed. These households are included in rent-to-income estimates but excluded in the core need approach. Miron maintains that the answer as to whether these households are included "presumably depends on one's perception of the household's ability to "downsize", and the social desirability of this" (p. 5.12). Here, if there is no housing problem, the core need approach is better. Conversely, if small units are scarce -- a housing problem -- the rent-to-income ratio is a better estimator of need.

Miron (1984) attempts to answer the income versus housing question. He employs Statistics Canada's 1978 Family Expenditure Survey. While this survey is conducted nationally and has a relatively small sample size, these estimates were the only ones found which address this issue empirically. The approach is straightforward. Miron ranks tenants by what they can afford (based on the 25 per cent ratio) and rental units by the rents they command. He assumes that households would choose a lower-cost unit if available and presents figures on the discrepancies between existing rental units and the number of households that cannot afford anything better. The results show that there are enough affordable units for all persons earning more than 6,000 dollars per year.

However, several limitations in the data are presented. One is that this survey considers spending units rather than households. There may be more than one spending unit in a household. This creates problems in matching tenants with rental units.

Perhaps the greatest difficulty with this approach is that these units are not 'available' as most are already occupied. Rather, this approach represents a re-allocation of rental units which may represent an ideal distribution only in terms of affordability ratios. Moving costs and geographical location are not considered.

3.7 Summary

A number of commonly held conclusions emerge from the literature. These include:

1. The problem of inadequate and crowded housing, while still a concern, has diminished as housing services have improved significantly over past decades.
2. Affordability, as defined, appears to be the most significant and widespread housing problem.
3. Tenants have incurred a disproportionately high incidence of affordability problems relative to homeowners.
4. While considerable regional variations exist, rental affordability problems have been significant in all urban areas surveyed.
5. Specific groups, particularly low income earners, the elderly, single women, and single parent households have more affordability problems than the population at large.
6. Refined estimation techniques, while reducing the overall incidence of hardship, tend to increase the estimates of affordability problems among low income tenant households. This group was not able to find adequate housing without paying a high share of their income towards rent. That is, according to both traditional and alternate measurement standards affordability problems among low income households have not merely been a matter

of expecting or consuming more housing than they could reasonably afford.

Methods of estimating need have become more complex as seen in the development of the core need approach and Miron's (1984) recent work. In turn, surveys may themselves incorporate questions which will better address the issues at hand. The literature cited in this section identifies several shortcomings in existing survey data which might be considered in future affordability surveys. These include (from Miron and Cullingworth):

1. Matching rents to income for the same time period. Surveys such as the Canadian Census often compare present housing expenditures with incomes for the previous year.
2. Data are often aggregated in an unhelpful manner leading to limited usefulness.
3. Similarly, more detailed analysis which considers the type or composition of individual households would be useful.
4. A clearer articulation of societal goals is necessary to better define what is affordable. There has been little study of public attitudes to social policy questions.
5. Although there is a relationship between the problems of housing inadequacy and affordability, they are, to a significant extent, different problems. Surveys often contain insufficient data to separate these problems in order to provide

clearer estimates needed to better direct government assistance to those in need.

Appendix 3A

Table of Affordability Estimates for Tenant Households

	Year	Approach	Source and Notes	Affordability Problems Incidence (%)
Canada	1974	25% Rent to Income Ratio	B(1)	28
	1974	Core Need (25% Threshold)	B(1)	24
	1980	30% Rent to Income Ratio	D	22
	1980	Core Need (30% Threshold)	D	18
	1981	25% Rent to Income Ratio	D	24
Ontario	1972	25% Rent to Income Ratio	F(2)	31
	1972	30% Rent to Income Ratio	F(2)	23
	1974	25% Rent to Income Ratio	F(2)	33
	1974	30% Rent to Income Ratio	F(2)	25
	1976	25% Rent to Income Ratio	F(2)	33
	1976	30% Rent to Income Ratio	F(2)	25
	1978	25% Rent to Income Ratio	F(3)	30
	1978	30% Rent to Income Ratio	F(3)	23
	1980	30% Rent to Income Ratio	D	22
	1980	Core Need (30% Threshold)	D	18
Metro Toronto	1976	Budgetary	A	18-22
	1980	Budgetary	E	18
	1980	25% Rent to Income Ratio	G	31
	1980	30% Rent to Income Ratio	G	17
	1983	30% Rent to Income Ratio	H	22
Durham Region	1976	25% Rent to Income Ratio	I	30
	1976	40% Rent to Income Ratio	I	11

	Year	Approach	Source and Notes	Affordability Problems Incidence (%)
Hamilton	1974	25% Rent to Income Ratio	C	34
	1980	25% Rent to Income Ratio	G	28
	1980	30% Rent to Income Ratio	G	14
London	1974	25% Rent to Income Ratio	C	37
	1980	25% Rent to Income Ratio	G	34
	1980	30% Rent to Income Ratio	G	10
	1983	30% Rent to Income Ratio	H	29
Ottawa	1974	25% Rent to Income Ratio	C	33
	1980	25% Rent to Income Ratio	G	26
	1980	30% Rent to Income Ratio	G	13
Sudbury	1980	25% Rent to Income Ratio	G	24
	1980	30% Rent to Income Ratio	G	12
Thunder Bay	1980	25% Rent to Income Ratio	G	29
	1980	30% Rent to Income Ratio	G	14
Windsor	1980	25% Rent to Income Ratio	G	33
	1980	30% Rent to Income Ratio	G	18

NOTES: (1) For major Canadian Urban Centers.
(2) Excludes those receiving government housing assistance.
(3) Excludes those receiving assistance both through government housing programs or relatives.

SOURCES:

A. Bureau of Municipal Research (1977)
B. Burke (1981)
C. CMHC (1976)
D. CMHC (1983)
E. Metro Toronto Planning Dept. (1980)
F. Miron and Cullingworth (1983)
G. Ontario-MOMAH (1982) Socio-economic Characteristics of Renters
H. Ontario-MOMAH (1983) Staff Report to the Commission of Inquiry into Residential Tenancies
I. Social Planning Council of Oshawa-Whitby (1981)

Notes to Section 3

(1) Central Mortgage and Housing Corporation was renamed Canada Mortgage and Housing Corporation in 1979.

(2) As found in Wigdor and Ford (1981, 2). See also Section 4 of this review for further details on government policies and expenditures.

(3) A description of the HIFE Survey is presented in Miron and Cullingworth (1983, 132-141).

(4) As found in Marks (1984).

(5) A comparison of the census and the Survey of Housing Units criteria is provided in Metropolitan Toronto Planning Department (1983, C4-C6).

(6) Other survey definitions of crowding include 2 or more persons per bedroom and minimum spatial requirements per person. For a discussion of such measures see Municipality of Metropolitan Toronto, Metropolitan Planning Department (1983, C1-C4).

(7) These data are preliminary results from a staff research report. See Ontario, Commission of Inquiry into Residential Tenancies (1985).

(8) The rise in single person households may be an indication of the increased importance placed on privacy. See, for example, Miron and Cullingworth (1983).

(9) Further research into the urban-rural facilities differential might consider the costs of obtaining these facilities in remote areas.

(10) See Lane (1977) for a discussion of the derivation of the 25 per cent rule of thumb.

(11) CMHC's Survey of Housing Units was conducted only once.

(12) That may have tended to understate rental housing affordability problems if temporary unemployment was more prevalent among low-income households.

(13) Another difficulty is the use of last year's incomes with this year's rents. Here, inflation becomes an important factor. For a further discussion of the problems associated with rent-to-income ratios see Ontario, Commission of Inquiry into Residential Tenancies (1985).

(14) See Archer (1980).

(15) Steele and Miron (1984) discuss poverty lines and low-income cut-offs.

(16) Relative price of housing refers to the price of housing relative to all other goods consumed. See Miron (1984).

(17) Life cycle patterns refer to the tendency for young households to go into debt, established households to save and senior households to supplement pensions and retirement incomes with their savings.

(18) Permanent income is derived from estimates of the present value of future expected income. See Miron (1984, 3.7-3.11) for further details.

(19) For a further discussion of these groups see Ontario, Commission of Inquiry into Residential Tenancies (1985).

(20) A probable reason is that most senior homeowners were retired and had no mortgages to carry.

(21) This suggests that the elderly, relative to other age groups, may have had an income problem rather than a housing problem, per se.

(22) The most significant refinements in affordability estimates tend to address the income question indirectly by eliminating those who are deemed to have sufficient income.

(23) It is not certain how this would differ from the budget approach.

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SECTION 4: HOUSING POLICY, PROGRAMS AND SUBMARKETS

4.1 Introduction

This review attempts to scan recent research relevant to Canadian housing policy and to comment on some salient features. A major part of this section concentrates on the framework of explicit housing programs which function to redress the housing problems of low and moderate income individuals and groups in society. Literature abounds on the merits and weaknesses of programs in alleviating housing affordability problems. The overall objective of this section is to examine the effectiveness of particular housing programs in meeting the housing needs and demands of various submarkets in the housing field.

4.2 Historical Development of Canadian Housing Policy

There has been a national housing policy in Canada since at least 1935, when the Dominion Housing Act was passed.(1) Since that time there have been four major National Housing Acts passed in 1938, 1944, 1949 and 1954. In 1964 and 1973 a further series of major amendments transformed the legislation (Rose, 1980, p. 17).

The National Housing Act of 1944 indicated the government's policy to encourage home ownership, in new construction only, through a program which resulted in the lowest first-mortgage interest rates in Canadian history (namely, 3 per cent). Private building did increase considerably following the passage of the 1944

Act, but it soon became apparent that many lower income people could not afford housing.

The concept of public housing became a reality under section 40 of Canada's National Housing Act in 1949. Under this early program, federal subsidies equalled 75 per cent of capital and operating deficits. The remainder was a provincial responsibility, part of which could be passed on to municipalities.

In 1964, the Government of Ontario, aware that the National Housing Act (NHA) would soon be amended to encourage the assumption of significant responsibilities by local or provincial authorities, developed the concept of a provincial housing corporation and created this agency with the passage of the Ontario Housing Corporation Act in June 1964. According to Rose (1980), the 1964 amendments virtually re-wrote most of the social provisions of the National Housing Act. The amendments included the following significant changes:

1. A new Section 16A was added to authorize loans to non-profit corporations owned by a province, municipality or any agency thereof, or by a charitable corporation for the construction or purchase of a housing project or housing accommodation of the hostel or dormitory type for use as a low-rental housing project. This amendment may be considered to be a substantial expansion of the former Section 16, the so-called "limited dividend section", but of most significance is the implication that the governments of the provinces would enter into this specific activity.

2. Part III of the National Housing Act was retitled "Urban Renewal" as distinct from its previous designation of "Urban Redevelopment". This part of the Act which had, from 1954, been comprised entirely of Section 23 was substantially

rewritten. This was the first time the phrase "urban renewal" was written into the National Housing Act and Section 33 was broadened considerably to encompass a broad-gauge approach to the prevention and treatment of blighted and slum areas in urban municipalities.

Specifically, Section 33 was expanded by the addition of new Sections numbered 23A to 23F. These sub-sections were designed to cover, respectively, contributions for preparation of a urban-renewal scheme, contributions for implementing an urban-renewal scheme, loans for an urban-renewal scheme, insured loans for housing projects in urban-renewal areas, authorization for expenditures from the Consolidated Revenue Fund, and regulations. As far as the governments of the provinces were concerned, Sections 2A, B, and C were most important. Not only were the provinces clearly recognized as the authority which must approve local urban-renewal plans, but the federal government agreed to pay one-half of the costs of preparing and implementing such schemes. In addition, Central Mortgage and Housing Corporation recognized for the first time that implementation would require the employment of persons to assist in the re-location of individuals and families dispossessed of housing accommodation by urban-renewal programs.

3. Section 36 of the 1954 Act, which was the first portion of Part VI, entitled "Federal-Provincial Projects," was re-numbered as Section 35A and Part VI was re-titled "Public Housing". Although the federal-provincial partnership had been in force since the end of 1949, this was the first time that the phrase "public housing" had appeared in the National Housing Act.

   Section 35A was, in fact, a re-statement of the earlier federal-provincial partnership, with the addition of the possible inclusion of hostel or dormitory type housing accommodation in federal-provincial housing projects. The 75-25 division of financial responsibility in both capital costs and losses (subsidies) between the federal and provincial governments was continued unchanged.

4. The entire field of public housing operations was broadened substantially with the enactment of new portions of Section 35 numbered 35B to E. In Section 35B the

term "public housing agency" was defined to include a corporation "wholly owned by the government of a province or any agency thereof", or "one or more municipalities in a province". This revised definition, along with the new financial provisions in Sections 35C to E, brought the Canadian provinces directly into the field of public housing for the first time in our housing history.

In Section 35C, Central Mortgage and Housing Corporation was permitted to make loans to assist a province, municipality or public-housing agency to acquire lands for public-housing projects. The maximum loan that might be made for this purpose was 90 per cent of the cost of acquiring and servicing the land. Since it was anticipated that a landlord-acquisition program would soon be followed by the construction of a public-housing project, loans under this section were expected to be for relatively short terms and in no case for more than 15 years.

This new Section was followed by another, Section 35D, which permitted the federal agency to make loans to provinces, municipalities and public housing agencies "to construct, acquire, and operate public housing projects". Loans made under this Section were to be subject to conditions similar to those applying to limited dividend housing companies and to non-profit corporations. In short, these loans could not exceed 90 per cent of the cost of the project as determined by the Corporation and would be for a term not exceeding fifty years from the date of completion or acquisition of the project. Finally, in the third new section, Section 35E, the federal Corporation was authorized to make contributions towards the operating losses of subsidized public-housing projects owned and operated by a provincial, municipal and public-housing agency for the benefit of persons of low income. The maximum federal contribution was set at 50 per cent for a period not in excess of fifty years.

In these new sections the National Housing Act was slanted in the direction of new forms of initiative by local or provincial governments. Clearly, the terms available in the completely revised Section 35 under the rubric "public housing" were far more favourable than the terms provided in the familiar federal-provincial partnership (although these provisions were retained as an alternative

> if desired by any provincial jurisdiction). The increase in the proportion of capital contributions was, of course, accompanied by a decrease in the proportion of subsidies which the federal government would pay; the amount of the subsidies however had rarely appeared to be a major consideration affecting the decisions on public housing of municipalities and provinces. The capital contribution, however, had been an important deterrent to local initiatives in most municipalities. (Rose, 1980, pp. 38-40)

The objective of public housing is to provide adequate quality accommodation for low income households most in need, at a rent they can afford. In Ontario, eligibility is limited to senior citizens aged 60 years and older, families with children, and physically and mentally handicapped persons. Rents are up to a maximum of 25 per cent of income. In 1974 in Toronto, the average household income of tenants in this housing was 5,028 dollars (Smith, 1977, p. 18). In 1981, the average household income of tenants living in Ontario Housing Corporation housing was just under 10,000 dollars (Ontario-MOMAH, 1983, p. 63).

After the NHA revisions of 1964, the public housing program (more properly called 'the rent-geared-to-income program') grew rapidly in Ontario, providing about 15 per cent of the housing starts in 1970 (See Table 1). Until the mid-1970s the majority of units were built for families, but recently a greater percentage has been for senior citizens. For instance, in Ontario in 1973, 65 per cent of the units built were for families, while in 1976 the proportion fell to only 7 per cent (Rose, 1977, p. 175).

Table 1: Public Housing Activity, Ontario 1964-76

Year	Units	Loans ($000)	Loan per unit ($000)	Percentage of all housing starts in Ontario
1964	40	261	6.5	-
1965	2,919	36,120	12.4	4
1966	4,661	59,206	12.7	9
1967	7,187	95,336	13.3	11
1968	7,739	87,472	11.3	10
1969	11,054	130,455	11.1	14
1970	10,385	128,438	12.4	14
1971	11,264	152,736	13.6	13
1972	8,466	113,681	13.4	8
1973	8,028	105,341	13.1	7
1974	5,287	82,174	15.5	6
1975	5,432	104,555	19.2	7
1976	5,638	116,720	20.7	7

SOURCE: Canadian Housing Statistics, CMHC, various years.

Reprinted from Fallis, 1980, p. 60.

Public housing projects are managed by a local housing authority or the Ontario Housing Corporation. The federal government provides a loan for 90 per cent of the capital cost and the province the remaining 10 per cent. Operating losses are borne 50 per cent by the federal government, 42.5 per cent by the province and 7.5 per cent by the municipality. In 1974 it was estimated that the total amount of operating payments was $99.3 million. The federal government supplied $49.6 million, while the province supplied $42.3 million, and the municipalities in which the housing projects were located supplied $7.4 million (City of Toronto Planning Board, 1975, p. 60).

Problems with the public housing program of the 1950s and 1960s led to a number of alternative programs, based on a rent supplement approach.[2] These programs began in 1971. However, their contribution was relatively small, accounting for under 0.5 per cent of Ontario housing starts (Ontario Economic Council, 1976). In these programs, the Ontario government provides first or second mortgages on favourable terms to private landlords who agree to rent 25 per cent of their units to tenants receiving rental supplements. The province provides the mortgage credit and the federal, provincial and municipal governments share the rental supplement costs.

The mid-1970s saw the introduction of a non-market, socially mixed approach to social housing -- the public, private and cooperative programs currently funded under Section 56.1 of the National Housing Act. Three distinct types of projects are covered by the non-profit and cooperative housing program:

- public non-profit projects which are developed by provincial or municipal non-profit housing corporations;
- private non-profit projects which are developed by non-profit corporations formed predominantly by sponsoring organizations such as church groups or service clubs or by informal community-based groups organized because they see a particular housing need; and
- cooperative projects which are owned collectively by the members of the cooperative with each member owning a share of the project but not the individual unit occupied by the member.

Under these programs, both private and municipally owned non-profit and cooperative projects are eligible for loans up to 100 per cent of the capital costs of the project; provincial non-profit housing corporations are eligible for 90 per cent loans. For non-profit projects, the maximum subsidy assistance available is the difference between the amortization costs at an interest rate of 2 per cent and those at the market rate of interest. This subsidy provides two types of assistance to these projects:

> 1. Most tenants in the projects pay what are described as "low end of market rent" (representing the lower range of rents for equivalent accommodation in the market area). Much of the subsidy assistance goes to paying the difference needed to cover costs in the project.
>
> 2. The subsidy remaining can be used to provide further assistance to tenants who cannot afford the rents in the project. Many of these income-tested tenants pay rents similar to what they would pay in public housing.
>
> (Clayton Research Associates Limited, 1984a, p. 29)

The CMHC study, Section 56.1 Non-Profit and Co-operative Housing Program Evaluation (1983) identifies three stated and three unstated objectives of the non-profit and cooperative housing program. The three objectives explicitly stated at the outset of the program are:

> 1. To provide modest, affordable housing appropriate to the needs of low and moderate income families and individuals;

2. To produce housing at minimum cost by implementing appropriate cost controls; and
3. To encourage approved lenders to provide capital for low and moderate income housing needs.

Three other objectives of the non-profit and cooperative housing program identified by CMHC are:

4. To achieve income integration in the projects and avoid the "ghetto" image which plague public housing programs;
5. To supplement the supply of affordable rental housing; and
6. To encourage the participation of the voluntary sector in the resolution of housing problems. (1983, pp. 5-6)

Prior to 1978 when the current programs began, non-profit and cooperative programs received fixed federal assistance through a low-interest mortgage. After 1973, a 10 per cent federal capital grant was added. The provincial government also provided a subsidy equivalent to a 10 per cent capital grant for most of the units. Units from these earlier programs remain in operation under the original funding formulae, but no new units are being constructed (Ontario-MOMAH, 1983, p. 70). Table 2 indicates that some 15,924 units were developed under the 'old' non-profit programs, about 56 per cent of which were 'family' units (Ontario-MOMAH, 1983, p. 70). Table 3 provides data on Section 56.1 Non-Profit and Cooperative programs in Ontario for the period 1978-82.

Table 2: Non-Profit and Cooperative Activity, Ontario 1966-76

Year	Units	Loans ($000)	Loan per unit ($000)	Percentage of all housing starts in Ontario
1966	748	5,291	7.1	1
1967	1,364	8,102	5.9	2
1968	872	5,358	6.1	1
1969	594	5,067	8.5	1
1970	496	3,804	7.7	1
1971	588	5,447	9.3	1
1972	954	6,672	7.0	1
1973	239	2,868	12.0	-
1974	3,663	51,010	13.9	4
1975	2,602	43,432	16.7	3
1976	3,804	74,599	19.6	4
TOTAL	15,924			

SOURCE: Canadian Housing Statistics, CMHC, various years.

Reprinted from Fallis, 1980, p. 70.

Table 3: Non-Profit and Cooperative Activity, Ontario 1978-82

Client Group	Municipal Non-Profit	Private Non-Profit	Cooperative	Total	Per cent Distribution
Senior Citizens	496	10,153	582	11,231	46.8
Families	1,683	3,811	6,074	11,568	48.2
Special and Others	40	1,149	11	1,200	5.0
Total	2,219	15,113	6,667	23,999	100.0

SOURCE: Ministry of Municipal Affairs and Housing and CMHC data, NHA Section 56.1 units under management, as of November, 1982.

Reprinted from Ontario-MOMAH, 1983, p. 71, Table 44.

A number of studies review the circumstances which led to the decline of public housing as a solution to low income housing needs.

A report by the Social Planning Council of Metropolitan Toronto (1984) contains a brief history of the development of assisted housing programs in Canada and also details the change in trends over the past few decades. The following trends are documented in other studies as well:

1. Widespread public opposition to large-scale public housing developments had brought the family housing program to a standstill by the early 1970s. Amendments to the National Housing Act (NHA) in 1973 and 1978 extended assistance methods.
2. The development of mixed-income approaches has been embodied by local non-profit and cooperative programs.
3. The number of beneficiaries of assistance has increased through subsidizing home ownership and assistance to developers of private rental housing.
4. There is now a shift in emphasis toward conservation and rehabilitation of existing stock.

The Council also observes that the last decade has been marked by the reduced overall public commitment to housing those in need of assistance:

> Direct federal spending on social housing has been greatly reduced by the termination of funds for both Section 43 public housing and land banking, and by substitution of private lender capital for direct government financing. The withdrawal of the provincial

> government has been even more severe. Subsidies to non-profit and cooperative projects have been terminated since 1978. (Social Planning Council of Metropolitan Toronto, 1984, p. vi)

The studies by the Canadian Council on Social Development (CCSD) (1977), the City of Toronto (1982) and Patterson (1970), all state in various ways that there has been a consistent decline of activity in the public housing program.

The CCSD report critically evaluates the effects of policies intended to improve the housing conditions of Canadians who are unable to compete in the private housing market. They provide the following rationale for the decline in the production of subsidized public housing:

> This is one indicator of the shift in housing policy and has coincided with growing awareness of the size of the problem involved and the costs of using this approach as its solution. (1977, p. 69)

Patterson (1970) notes that the public housing program has lost support from municipal governments, ratepayer groups, and in some cases, tenants themselves. He also adds that all three levels of government have reacted against rising subsidies (p. 296).

Rose (1977) discusses changes in social housing policies and changes in factors affecting such policies in the mid and late 1970s. Rose observes that there have been shifts from public family housing to senior citizen housing; from low income rental housing to moderate income homeownership; to the decentralization of responsibility for social housing to local and regional governments; and to increasing concern about financial subsidies in social housing. These shifts have been reinforced by underlying social and economic factors which exist and change the context in which social housing policy is conceived -- for example, unemployment and inflation, the rise of the non-family household and the increase in importance of the elderly.

4.3 Public Housing

Although public housing programs have served and continue to serve the most needy Canadians with low-rent housing based on their ability to pay, these housing programs have been held in disfavour by various housing analysts and government officials.

There appears to be a general acceptance of the Hellyer Task Force's contention that public housing projects were "ghettos of the poor; people who lived in them were stigmatized in the eyes of the rest of the community; social and recreational facilities were inadequate or non-existent; privacy was lacking and vandalism present."(3)

How representative these conclusions were in 1969, or are now, is unclear. There is, however, evidence that bad siting(4) and inadequate management(5) have plagued public housing projects. Still, neither shortcoming is inherent in the concept of public housing.

The CCSD report, A Review of Canadian Social Policy (1977) provides a broad discussion on public housing. In part, this critical review examines problems which hamper the survival of the public housing program. The review proposes that problems arise from both the point of view of tenants and government.

Tenants are concerned with social issues, with their relationships to public housing management and authorities and with the effect of government policies on their everyday lives. One important concern for residents of subsidized public housing is the concentration and type of tenants that characterize many public housing projects. To resolve this problem, the CCSD report submits that pursuit of an income mix policy may make public housing more politically and socially acceptable. It also adds that more dwellings must be built to accommodate those in most acute need (CCSD, 1977, p. 67).

Another difficulty in which the public housing program now finds itself is due to the quality of life built into the projects and the fact that "they have failed to accommodate the needs and requirements of their residents" (CCSD, 1977, p. 160). This report notes that families in public housing have expressed the need for extensive recreation, social and childcare facilities. The families are also acutely aware of design and management limitations of public housing.

On the part of the federal and provincial governments, the main cause for current disinterest in public housing is due to the rising costs of rent-to-income subsidies.(6) The explanation given is that, while rental receipts in public housing have been virtually static, high construction costs, land costs and financing costs have increased the basic cost of providing new units. At the same time, operating costs have been increasing.

The CCSD review also addresses itself to the broader question of the function and distribution of public housing subsidies. That is, "are subsidies distributed proportionally to those most in need of assistance, or do they tend to favour the higher income households at the expense of the lower income clients?" (1977, p. 87) Basing their analysis on work done by the British Columbia Interdepartmental Study Team on Housing and Rents in 1975, the Council determined that a considerable range of subsidies were received by tenants with the same income. By controlling for rent levels, data showed that for all economic rent groups, the dispersion about the line of horizontal equity (i.e. when similar households receive similar assistance) was considerable. For rental units within the rent range of $100-$140 per month, the amount of subsidy received by tenants with $200 income ranged from under $40 to nearly $80 a month; and for the tenants with incomes in the $600 a month range, the subsidy received varied from zero to $70 a month (1977, p. 88). However, the data also indicated that there was an overall tendency for higher subsidies to be received by lower income tenants.

The above analysis tends to suggest that the distribution of subsidies in public housing may not be economically equitable.(7) However, the data upon which the conclusions are based should be observed with reservation since they do not take family size and other relevant factors into consideration.

Fallis (1980) undertook a study to estimate the direct benefits to tenants in public housing. He determined that among the participants in public housing in 1970, the pattern of benefits seemed to satisfy the criterion of vertical equity (i.e. where people with different incomes receive a systematic, graduated amount of subsidy, the poorer recipients receiving more than higher income people). There was, however, a significant problem of horizontal equity: many households eligible on grounds of income are denied entrance to the program.

> This inequity is largest at the lower income levels, as the percentage of eligible households participating rises over the first three income classes. This can be seen as a form of vertical inequity as well, because the probability of participating in the program rises with income. (Fallis, 1980, p. 66)

Fallis concludes:

> Public housing performs rather well in distributing benefits to those in greatest need -- among those who participate in the program. Its benefits are concentrated on its target group, with over 75 per cent of the households from the lower third of the income distribution. Against this must be offset the fact that many deserving households on the basis of income do not participate in the program, while others of greater income do. (1980, p. 69)

Marks (1984) raises the question of whether public housing is built where it serves the greatest need. He presents five main criticisms of public housing:

1. The provision of new or recently built housing to low-income households is inefficient. It is argued that it would be more efficient to rely more on the filtering process of the private market.

2. In its long history, public housing has not solved the housing problem, in large part because of its expense.

3. Public housing does not promote the greatest satisfaction among the recipient households for the money spent.

4. This report strongly recommends that the public housing program in its present form (the construction of new highly-subsidized units to be owned by the public and occupied only by the poor) be abandoned. Some of the reasons for doing so are contained in our review of program performance: the poor locations found for residual housing, problems of design caused by cost cutting or attempts to build outstanding housing for the poor; high density; high-rise housing dictated by cost concerns; insensitive management that treats public housing tenants as welfare clients; the negative attitudes of administrators, surrounding neighbourhoods, and the public generally. All are aspects of the stigma inherent in a program aimed at the poor. (Dennis and Fish, 1972, p. 218)

5. Public housing establishes special treatment for low-income households and thereby isolates and stigmatizes them.

(Marks, 1984, pp. 77-78)

As mentioned in the Hellyer Report and in a few other studies, there has been a widespread view that it is community attitudes which prevent the development of public housing. Yet, some doubt has been raised about how widespread or deep these negative feelings are. Cullingworth submits that, in view of the apparent lack of objection to the particular type of public housing as 'senior citizens housing', "it would seem that further inquiry is needed on attitudes to, and the design and management of public housing. This is particularly important since this is the only housing program which makes direct provision for the poor." (8)

In retrospect, the trend toward non-profit and cooperative housing policies was an attempt to meet some of the criticism of public housing by encouraging the dispersion of low income households among other households in given projects. The establishment of the non-profit and cooperative programs as a replacement for public housing projects was one of the recommendations of the Hellyer Task Force:

> Greater encouragement be given to the limited dividend, non-profit and cooperative projects as a means of providing adequate accommodation for lower-income groups. (1969, p. 37)

4.4 Non-Profit and Cooperative Housing Programs

With amendments to the National Housing Act in 1978, the main thrust of the federal government's social housing policy(9) has been the Section 56.1 Non-Profit and Cooperative Housing programs.(10) These programs have been criticized on various counts in several studies.

One document by Canada Mortgage and Housing Corporation (1981) introduces options for possible directions to resolve social housing policies. This report criticizes current social housing programs (both public housing and the Section 56.1 programs) on two counts:

1. The subsidies treat people in the same income and household size class unequally; those who are in it

benefit from substantial subsidy; those who are not obtain no direct benefit. (Fallis (1980) makes the same point.)

2. The subsidies are regarded as expensive, on the grounds that per unit subsidy costs are high.

Another CMHC (1983) study evaluates the Section 56.1 programs, to determine the extent to which the programs are achieving the objectives established for them, as well as to assess the continued rationale for the programs and their broad impacts and effects. (The objectives of these programs are set out in subsection 4.2.) In its evaluation, CMHC submits that two out of the three objectives are likely to be in conflict with the objectives specified in program manuals. For one thing, the achievement of a mix of incomes among Section 56.1 households conflicts with the stated objective of focussing on low and moderate income households. CMHC also argues that the achievement of increases to the stock of rental housing conflicts with the objective of providing housing at minimum cost. This is because additions to the rental stock are generated primarily through new construction and the cost of providing such rental housing is higher than the cost of acquiring existing units.(11) CMHC proposes that if program funds were concentrated on the acquisition of lower cost existing units, more units could be made available to low and moderate income households. However, this approach would increase the stock of rental housing minimally (1983, p. 161).

In its assessment of the Section 56.1 programs, CMHC suggests that they "are ineffectively targetted to those most in need" (1983, p. 8). CMHC reports that between 47 and 69 per cent of the households served by the programs would be considered to be low and moderate income. Only 21 per cent of the programs' recipient households fall below Statistics Canada low income cut-offs, although the incidence of need for social assistance is overwhelmingly concentrated among this income group. This report provides three reasons to account for the relatively low achievement of this objective:

1. Subsidy arrangements for programs require that a mix of income groups be accommodated to ensure that projects are viable.
2. No operational definitions for low and moderate income are provided in the delivery of programs. This implies that no firm guidelines are in place to ensure that low and moderate income households are served by programs.
3. It is observed that although programs are designed to serve low and moderate income households, affordability problems are created because of the high level at which market rents are often set.(12) An analysis of the lower end of market rents indicated that rents are unaffordable to senior citizens with incomes below median renter incomes or for family households in some centres living in recently-committed new units.

In its summary, CMHC concludes that:

> The findings with respect to low and moderate income identify inconsistencies between the design of the programs and the objectives, as well as the lack of specific guidelines related to this particular objective. (1983, p. 314)

Clayton Research Associates (1984a), extracting from the 1983 CMHC study, suggest that the problem with the program is that, by design, the large subsidies are diluted by dividing the total subsidy funds not only among low and moderate income groups but among others as well. This occurs because subsidies are provided to all units to bridge the gap between break-even rents and the low end of market rents. The result is that:

> Rather than subsidizing only low and moderate income tenants, non-profit and cooperative housing divide the subsidy among all tenants. (p. 32)

Clayton Research Associates also identifies a significant variation among non-profit and cooperative projects in terms of providing the income-tested units necessary to house low income tenants. Fifteen per cent of the units surveyed by CMHC were in projects where there were no assisted households. A further 14.2 per cent were in projects where less than 10 per cent of the households were assisted. In these projects, almost all of the subsidy available was used in lowering rents for all tenants; there was none left for the extra assistance necessary for income-tested tenants (1984a, p. 33).

On a similar note, the City of Toronto's 1982 Annual Report criticizes the 56.1 federal programs as being an inadequate response to housing needs of low and moderate income households. Concern is expressed about an absence of a coherent overall housing policy framework:

> There is no comprehensive housing policy strategy, at either the federal or the provincial level, which ensures that taxpayer dollars are spent efficiently, that program development and modification is orderly and not ad hoc, and that those most in need receive the most attention (City of Toronto, 1983, p. 10).

An analysis of the operations of Cityhome - Metropolitan Toronto's municipal non-profit program - in the Annual Report (1983) revealed several limitations of the Corporation to respond to the needs of the most disadvantaged groups. The view put forth is that the Corporation's growing success has been seriously undermined by reduced resource allocations. As well, a number of program restrictions hinder the City in meeting its stated objective of ensuring that all its citizens are adequately housed. In particular, the municipal non-profit program completely excludes lower income, non-senior singles and couples (and this group is becoming a sizable and especially hard-pressed component of the City's population according to this report and others).

The Canadian Council on Social Development (CCSD) (1977) presents a broader perspective on the 56.1 programs. The Council observes that non-profit and cooperative housing developments have provided housing for families and senior citizens, principally by means of rehabilitation in the inner city. The cooperative societies have provided dwellings but the level of production has been disappointing. For instance, in 1975, three per cent of new or rehabilitated stock was generated by this sector (see Table 2). Clayton Research Associates (1984b), by combining the 1981 census figures on the occupied rental stock with estimates of rental units completed since the census, calculated that approximately 12 to 13 per cent of Ontario's rental stock is owned by the public or third-sector (includes non-profit and cooperative housing projects) (p. 76).

CCSD (1977) undertook a partial evaluation of the delivery mechanism and exposed some problems plaguing the third sector. The main problem was found to be the lack of development capital. Federal start-up funds, federal and provincial financing for resource organizations and changes in CMHC mortgage fund advancement policies have all been available. However, none of these have been sufficient to overcome the problems resulting from the lack of front-end capital funds and development expertise. Moreover, funds for community resource organizations are not secure. CCSD submits:

> Relative production levels will not increase as long as production is totally dependent on the efforts of small individual groups, each investing the majority of its limited time and energy in the pre-development phase of projects. (1977, p. 161)

This study reiterates the claim made by previous studies that present break-even rents in some non-profit housing projects are not affordable for lower income tenants. What is urged are more rent supplements:

> Since economic rents in new projects are so high, one wonders at the restriction of rent supplementation to 25 per cent of the units. There could be a need for deep subsidies across all the units so that even moderate income tenants could afford the rents. If this is not done, there is a strong danger of a large income gap developing between the very low receiving supplements and those able to pay economic rents. (CCSD, 1977. p. 136)

Thus, a possible problem with moderate income affordability is identified.

Many of the studies cited tend to suggest that public, non-profit and cooperative housing programs have been inadequate in meeting the housing needs of low and moderate income groups. Available data tend to support this viewpoint. With regard to public housing, Table 4 indicates the total waiting list for Ontario Housing Corporation (OHC) rent-geared-to-income housing. Ontario-MOMAH (1983) points out that the increase has been for 'families' and the senior citizen totals have actually continued to decline. Also, most of the units that became available in this period were for senior citizens (1983, pp. 66-67).

Table 4: OHC Rent-Geared-to-Income Housing
Historic and Current Waiting Lists
1976-1982

Year	Families	Senior Citizens	Totals
1976	17,945	19,115	37,060
1977	13,807	15,743	29,550
1978	11,015	11,468	22,483
1979	10,185	8,041	18,226
1980	10,697	8,015	18,712
1981	12,457	7,233	19,690
1982	17,974	6,947	24,921

SOURCE: Ontario Housing Corporation.
Reprinted from Ontario-MOMAH, 1983, p. 67.

CMHC data for the 'old non-profit programs' (prior to 1978) indicate that 86 per cent of tenants in non-profit and cooperative housing in Ontario had annual incomes of under $20,000 and 25 per cent under $5,000; 46 per cent were individuals. (Most senior citizens and nearly all 'special housing' residents fall into the category of individuals.) Forty-two per cent of all tenants and 27 per cent of market-paying residents had one or more children (Woods Gordon, 1981, pp. 26-29). Ontario-MOMAH (1983) suggests that some family and senior citizen residents appeared to have an affordability problem.(13) The Ministry bases its position on CMHC data that 32 per cent of senior citizens and 14 per cent of families, who were not in rent-geared-to-income units, were paying more than 30 per cent of income as rent (Woods Gordon, 1981, p. 29).

CMHC data for the Section 56.1 non-profit programs (1978 onwards) in Ontario indicate that about 26 per cent of families and 55 per cent of senior citizens pay more than 30 per cent of income for rent. Within these groups paying more than 30 per cent, about half, or 10-15 per cent of families and 25-30 per cent of senior citizens, pay more than 40 per cent of income (Ontario-MOMAH, 1983, p. 75). The Ministry suggests that:

> Over time, if rents increase faster than incomes, this affordability problem would be greatly exacerbated (Ontario-MOMAH, 1983, p. 75).

In addition, the rapidly escalating cost of constructing and operating public and non-profit housing projects has become a growing concern among government officials. Consequently, alternative approaches have been advocated to replace the existing housing assistance programs.

4.5 Housing Allowances

Outside of government, increasing attention during the 1970s was given to the question of the adoption of shelter/housing allowances. This has been partly stimulated by experience with provincial schemes in British Columbia, New Brunswick, Manitoba and Quebec, partly by the United States' experimental housing allowance schemes, and partly by the increasing use of this policy in Europe.(14)

In Canada to date, it seems that most housing allowances have evolved as adjuncts to income supplementation policies, not as an integral part of the total support system, but rather as a response to inadequate levels of income transfers (Canadian Council on Social Development, 1979, p. 3). Furthermore, Canadian plans (with the exception of Manitoba programs) have tended to rely on a targetted approach, usually providing assistance only to low income senior citizen renters. In contrast, experimental American programs developed over the 1970-1980 period generally used grants based on a recipient's income compared with the cost of adequate accommodation (not necessarily the actual rent paid), and depended to a lesser degree on narrow target groups such as low income family households and the handicapped, as well as senior citizen renters. In some cases, even homeowners were eligible to receive housing allowances (Falk, 1982, p. 11).

Several Canadian studies examine a range of issues related to housing allowances.

CMHC (1981) regards housing allowances as offering clear advantages in addressing a wide range of substandard housing problems. In its opinion, housing allowances allow freedom of choice in terms of a dwelling; they apply primarily to housing; they are comparatively easy to administer and most importantly, horizontal equity is achieved since all members of the qualifying groups are eligible for housing allowances.

> This would offer large numbers of households an immediate opportunity to bring their housing standards up above substandard levels. (CMHC, 1981, p. 7)

However, this report also identifies two principal limitations of housing allowances:

1. They are likely to be wasteful in tight urban markets;
2. They are not likely to be effective, on their own, in rural and remote areas.

With regard to the first limitation, CMHC suggests that, with a low vacancy rate in the rental sector, households can obtain better accommodation only by bidding it away from others in the nearest higher income groups. This raises rents and it places pressure on the income groups closest to the subsidized households in terms of income and housing need. The second limitation stems from doubts expressed about the effectiveness of housing allowances in hinterland areas, in regions of generalized rural poverty, and in small towns. CMHC suggests that the housing problem in these areas may not be of distribution but of aggregate supply. In such cases, market rents may not be sufficient to meet the costs of production and to generate housing output. Consequently,

> The main requirement is to enable people to improve what they have, or to build something new, not to provide them with funds to bid accommodation away from somebody else. The problem is one of aggregate supply, not distribution. (1981, p. 9)

CCSD (1978) provides a comprehensive analysis of housing allowances. This paper contains a description of the measures used to judge the performance of housing allowances. Other issues examined are: the relationship of housing allowances to income supplementation, the relative roles of various levels of government in financing and administering housing allowances and the design of housing allowances in light of conflicting aims and objectives.

The CCSD paper also assesses existing housing allowances and future directions for public policy. Current Canadian housing allowances are measured against criteria that meet recipients' needs first and then are set against criteria that satisfy the government's administrative objectives. Similar concerns expressed by the recipients are the following:

1. The assistance must be adequate to meet shelter costs.
2. It must be accessible and obtainable.
3. There should be freedom to choose housing and location.
4. Treatment must be fair in relation to other recipients.

The main concern of the government is the cost-effectiveness of the assistance program.

CCSD (1978) makes the suggestion that some of the public policy criteria may conflict with client requirements and that trade-offs will have to be made (see CMHC, 1983). (Similar types of conflicts have been recognized in public and non-profit housing programs as well.) The participants at a symposium held by CCSD reached a general conclusion that housing allowances are at best 'stop-gap' measures. All agreed that "housing allowances will never replace more comprehensive income support and publicly assisted housing programs" (CCSD, 1979, p. 5).

Studies by the Association of Municipalities of Ontario (AMO) (1981) and the Social Planning Council (1984) both express serious reservations about housing allowances. The AMO argues that housing allowances do not guarantee accommodation of a particular quantity, quality or type or in a specified location. In particular, this report identifies two main problems with housing allowances:

1. They are potentially inflationary and will reinforce social segregation in cities.
2. They do not allow governments to meet other social objectives which construction of assisted housing does.

In addition, it is suggested that most housing allowance schemes do not provide a deep enough subsidy, thus the recipient is still left with an onerous rent-to-income ratio (AMO, 1981).

In its summary, this report maintains that housing allowance programs may help to alleviate affordability problems for some household types in markets where there is a plentiful supply of appropriate housing and where assisted housing is neither available or viable. However, the authors warn that any housing allowance scheme must be seen as a complement to existing programs and if such a program is developed, it should be limited in scope (to certain groups and to certain markets) and monitored closely (AMO, 1981, p. 24).

The Social Planning Council (1984) rejects the viability of a limited housing allowance scheme because of the numbers in need of housing assistance and the depth of assistance. Based on their estimates, the Council determined that about 70,000 households (in Metropolitan Toronto only), 45 per cent of them families with children, almost 30 per cent of them non-elderly singles or couples without children, and over 25 per cent of them elderly singles or couples, already require some form of rent-geared-to-income housing, or will require it within 15 years (p. 77).

Falk (1982) provides a broad analysis of the desirability and implementation of a national housing program in Canada. Falk maintains that the rise in popularity of the housing allowance approach (as evidenced by the introduction of the present provincial plans -- See Table 5) reflects political disenchantment with direct subsidy programs (such as public housing) on economic as well as philosophical grounds. In addition, he submits that the approach coincides with an ever-increasing reliance on the use of private capital to finance the production of subsidized housing units (1982, p. 11).

Following the same line of argument as previous studies, Falk submits that a fundamental contradiction exists in the objectives of a housing allowance program. In his opinion, while an allowance program can effectively handle problems of affordability, it is not as effective in dealing with housing adequacy problems:

> Households may move from substandard to adequate accommodation as a result of receiving a housing allowance, but to do so involves increasing housing expenditures and offsetting the improved affordability which the allowance program is intended to offer. (Falk, 1982, p. 11)

Thus, a basic conflict exists between addressing quality and affordability problems. Falk offers no suggestions as to how this basic conflict can be resolved.

Falk concludes that a national allowance program will resolve many affordability problems, however, it will not resolve all of the nation's housing problems. In his opinion, the implementation of a national plan without the development of a comprehensive strategy may lead to other difficulties, especially in tight market areas.

Since housing allowances have not been a central focus of housing policy anywhere, literature assessing current housing allowance programs has been limited. Falk's study does provide a brief summary of recent reviews by the Manitoba Housing and Renewal Corporation (MHRC) of its existing housing allowance programs.(15) The Manitoba programs are available on a more general basis than other Canadian plans; pensioners who are 55 years of age and over, and low income family renters, as well as low income elderly renters are eligible for allowances (see Table 5). MHRC concluded that both Manitoba's programs seem to have experienced a measure of success in providing allowances to the intended users:

> The three to four thousand senior citizens eligible for the Shelter Allowance for Elderly Renters (SAFER) program tend to have extremely low incomes and would have had housing expenditures in excess of 40 per cent: as a result of the program, these expenditures have been reduced to 25 to 30 per cent. (Falk, 1982, p. 15)

Falk adds, however, that the successful implementation of the Shelter Allowances for Elderly Renters (SAFER) program may have been due to the generally soft rental

Table 5

Summary: Canadian Provincial Housing Allowance Programs

	British Columbia			**Manitoba**						**Quebec**			**New Brunswick**	
Program	Shelter Allowance for Elderly Renters (SAFER)[1]			Shelter Allowance for Elderly Renters (SAFER)[2]			Shelter Allowance for Family Renters (SAFFR)[2]			Shelter-Aid for Seniors (Logirente)[3]			Rental Aid to the Elderly[4]	
Year Introduced	1977			1980			1981			1980			1978	
Eligibility	low-income elderly renters; 65 years of age and older			low-income elderly renters; pensioners age 55 and older			low-income families with children			low-income elderly renters; 65 years of age and older			low-income elderly renters; age 65 and older	
Formula	75% × (eligible rent − 30% of income)			60% (higher income) to 90% (lower income) × (eligible rent − 25% of income)			60% (higher income) to 90% (lower income) × (eligible rent − 25% of income)			75% × (eligible dwelling cost − 30% of income)			50 to 75% × (rent in eligible unit − 30% of income)	
	Singles	**Couples**	**Sharers**	**Singles**	**Couples**	**Sharers**	**Two Person**	**Three Person**	**Four Person**	**Singles**	**Couples**	**Sharers**	**Singles**	**Couples**
Maximum allowance	$134	$65.35	$23.08	$140	$140	$140	$150	$150	$150	$88.77	$54.15	$53.40	$98	$109
Maximum eligible rent	$330	$365	$365	$270	$300	$300	$300	$325	$350	$215	$230	$145	$205	$230
Average client's rent	$259	$312	$194	$227	$269	$156	$259 One Parent	$254 Two Parent	$257 All Families	n.a.*	n.a.	n.a.	$222	$222
Average payment	$62.83	$25.22	$8.81	$64.45	$37	$35	$79.32 One Parent	$76 Two Parent	$78 All Families	n.a.	n.a.	n.a.	$39	$39
Average annual income	$6169	$10 527	$5921	$6228	$8892	$5280	$7608 One Parent	$8316 Two Parent	$7860 All Families	n.a.	n.a.	n.a.	$5688	$5688
Number of clients	10 047	969	246	2984	276	100	748	429	1177	18 405 incl. 960 owners	792	n.a.	n.a.	n.a.

Source: Canadian Council on Social Development

[1] Statistics compiled as of June 1982.

[2] Statistics compiled as of June 1982; low-income range $6000 for singles, $10 500 for couples and sharers (SAFER) and $8500-$10 500 (SAFFR); high-income range $11 000-$13 000 (SAFER) and $13 000-$15 000 (SAFFR).

[3] Statistics compiled as of August 1982; maximum allowances and rent levels as of October 1982.

[4] Statistics compiled as of June 1982.

*n.a.: not available

SOURCE: Falk, 1982, p. 12

market conditions existing in Winnipeg. Moreover, until the advent of the Shelter Allowance for Family Renters (SAFR) program in 1981, housing allowances in Manitoba affected less than five per cent of Winnipeg's rental stock. Falk submits that the market impact of SAFER has been limited.

The review also expresses concern about the limited success MHRC has experienced with participation. In 1981, less than 30 per cent of Manitoba's eligible elderly households were participating in the SAFER elderly program. No satisfactory explanation was given for this experience in MHRC's review. The MHRC review concluded that "shelter allowances will not guarantee a supply of adequate housing...there exists other programs and incentives better designed to perform this task"(16) (Minuk, 1982, p. 2).

Mark (1981) provides some insight into how housing allowance schemes have been performing in the United States. A large-scale housing allowance experiment, the Experimental Housing Allowance Program (EHAP), has been in place in the United States since the early 1970s. The experiment has focussed on the responses of both demanders and suppliers to various housing schemes, as well as examining the behaviour of administrative agencies which operate the allowance schemes. Some of the results indicate that:

1. Participation rates are lower than expected.(17)
2. Much of the allowance tends to be spent on non-housing goods.

3. Repairs to make housing units adequate are often minor.
4. There are small, if any, increases in rents as a result of the allowance.[18]

(Mark, 1981, p. 8)

Struyk and Bendick (1981) determined that households participating in EHAP experienced an easing of affordability problems:

> At enrollment, rent burdens in the Demand Experiment sites averaged approximately 40 per cent. Housing allowances sharply reduced recipients' contribution to rent and reduced rent burden to an average of 25 per cent in the Demand Experiment sites. (1981, p. 13)

Other studies which examine EHAP in several local markets in the United States are Bradbury and Downs (1981) and Friedman and Weinberg (1983).

The results of the American experiment provide some inkling as to what one could possibly expect to happen in a housing allowance program in Canada.

4.6 Evaluation of Housing Programs

Much public debate about housing programs has stemmed from an unstated premise that the various approaches of housing policy offer alternative or substitute solutions for the problem. Yet, it is interesting to note that all of the cited studies which discuss the feasibility of developing a housing allowance program reach the consensus that this program alone would be inadequate to deal with the housing problems of low income groups. A general agreement exists that there is room for all types of programs and that a diversity of programs can operate in conjunction with one another to serve the housing needs of low income groups.

CMHC neatly summarizes the common view in this statement:

> Their impacts should be seen as complementary, rather than competitive, and that there is no single best technique. (CMHC, 1981, p. 3)

Several studies cited have expressed the concern that concomitant to an integration of housing programs is the need to define and clarify the objectives of housing programs. These studies have observed that a variety of conflicts between the design and use of housing programs have created a deficient housing delivery system.(19) Various studies have attempted to offer their own insights into the crux of the problem.

Both Cullingworth (1980) and the CCSD (1977) present the argument that the design and objectives of current housing policy have been greatly complicated by the political dimension.

> Some major housing issues are not capable of resolution in the manner of a mathematical puzzle. There is no "right" answer: at most there is a line of policy which appears to meet the largest degree of acceptance on the part of those participating in the policy-making process. (Cullingworth, 1980 p. 21)

The CCSD recognizes that a multiplicity of interests are involved in the housing delivery system and suggests that:

> Policy formulators and policy implementers respond to differently perceived needs and goals, causing tensions and resulting in a deficient housing delivery system. (1977, p. 15)

Taking note of the subtle political dimension as well, Fallis presents a critique of the situation:

> Housing programs in the past have evolved in a chaotic and ad hoc fashion. A program was initiated in response to each complaint, but only a small fraction of the eligible was ever assisted. There was no systematic exploration of the rationale for government intervention, no assessment of the fairness of the entire policy and little attempt to place policy in the broad context of our income security system. (1981, pp. 22-23)

As a remedy, Fallis suggests that:

> It is of fundamental importance in the design of housing programs to understand whether the purpose is to increase the consumption of housing or to raise the well-being of the participants. (1981, p. 13)

He argues that a program designed to raise the well-being of the household would offer assistance in cash with no constraints on how the money is to be spent. An equal cost program, designed to maximize the increase in housing consumption, would offer a quantity of housing at a reduced price, such that a household would end up consuming more housing and less of other things.

In a similar vein, Mark (1981) presents the argument:

> If the goal of policy is to maximize the utility and choice of the household, then surely the unrestricted cash grant is the preferred method of delivery. If, however, the goal is to ensure the consumption of adequate housing, then the supply side program

> described should be emphasized. Unless this simple but fundamental question is answered, the choice between policies and choices will remain difficult, if not impossible to answer. (1981, p. 9)

However, both Fallis' and Mark's criticisms of the "something for everyone" approach to housing policy ignores its political attractions (Cullingworth, 1980, p. 29).

To improve the design of housing policy, one idea put forward is that housing problems of the poor may be treated as income problems, not housing market failure, and that income transfers are a more appropriate mechanism for dealing with these problems than is the production of new subsidized housing.(20)

Fallis (1981) advocates direct income supplements as alternatives to existing assistance since he believes Canadian housing programs should be recognized as part of the larger income support system.

David Greenspan (1979) promotes the view that, the poor need 'income policies', while the middle income groups need 'housing policies'(p. 7). He states his case in explicit class terms:

> In the present political climate, if the working middle-class perceives social policy treatment by Ottawa as fundamentally unfair over a long period compared to the social policy treatment received by other class, it will inevitably attack some programs which favour the poor. (1979, p. 7)

It is difficult to determine whether the above view is politically valid since limited research has been undertaken on public attitudes to social policy questions. This raises the point made by Cullingworth, that evaluation studies have tended to be concerned not with policy, but with programs or even with projects (Cullingworth, 1980). As well, Cullingworth has observed that much of the research has been narrowly focussed and has lacked a contextual framework. Cullingworth (1980) suggests that further research is required which poses policy questions in the context of 'particularities' -- of time, location, cost and a host of political and other constraints (p. 61). Studies of these contraints (common in the United States and to be found in Britain) have been lacking in Canada.

4.7 Problems of Housing Submarkets

Traditional federal housing programs have been targetted to families, senior citizens, some disabled people and native groups. This has brought the charge in several recent studies that a large variety of housing needs and demands in the province and in particular locations and situations are still not being met. Concern is expressed that other household types, outside of the traditional ones, are experiencing severe difficulty in obtaining affordable housing,(21) and these households are going to comprise a large segment of the total population in coming years. In particular, the AMO (1981) urges that government programs be expanded to encompass new recipient groups, in particular, single persons and childless couples over 45 years of age. The Association also suggests that the eligibility criteria should be modified to allow public housing communities to evolve into a more diversified socio-economic mix.

More generally, the CCSD (1978) voices the concern that inadequate assistance is being provided for the growing number of households for whom home ownership is not a viable option. Subgroups of the population that typically rent are identified: older single persons, senior citizens, young singles and students, disabled persons, mother-led families, the working poor and families of income levels who cannot afford a home.

Several regional case studies have focussed on various 'housing submarkets' and their immediate housing concerns.

The Interdepartmental Task Force report by the City of Toronto (1982) focusses on affordable housing for smaller households and also examines those aspects of affordability related to the lowest income segment of the unattached individual population. One conclusion of this report is that senior levels of government have not addressed the housing needs of low income unattached individuals in terms of either supply or affordability. The report notes that low income singles and couples have never been favoured by federal or provincial housing and rent subsidy programs. (No rationale is provided.) Yet, smaller households represent a rapidly growing section of Toronto's population and the report's statistics indicate that this group earns less than families as a whole. The report strongly encourages the creation of smaller units.

A City of Toronto Planning Board (1975) report focusses on the problems of low income single people in Toronto. A number of trends are identified -- indications point to an increase in supply for single people with high and stable incomes, but a decrease in supply for those at the lowest end of the economic scale. Concern is expressed that single people on low incomes in Toronto will be increasingly hard-pressed to secure housing at prices they can afford. Several implications related to this situation are noted:

> Low income individuals will be forced to either share accommodation, make do with a lower quality of housing, or spend an even greater proportion of their income on rent. (City of Toronto Planning Board, 1975, p. 15)

This report suggests that assisted housing programs should be expanded to provide accommodation for low income single people.(22)

One major finding of the extensive report by the Regional Municipality of Waterloo (1982) is that government programs being used in the region for the delivery of assisted rental housing have been insufficient for meeting the expected need for assisted rental housing. In their view, there exists a serious need for additional assisted rental housing for single parent families and few supply mechanisms are available to deliver these units. This study also sees a need for additional assisted rental units for senior citizens.

The CCSD makes the claim that federal and provincial housing production programs are increasingly failing to meet the needs of low and moderate income families with children (1977, p. 157). The number of families on the OHC rent-geared-to-income housing waiting list (Table 4) provides some support for this claim. The CCSD observes that currently, only about one-third of new public housing commitments by the federal and provincial governments are designed to house families. The remainder are being allocated to the elderly or 'special groups' (1977, p. 156). In addition, only forty per cent of the housing currently developed under the non-profit and cooperative sections of the National Housing Act is intended for low and moderate income families. Most of the remainder is for the elderly. Furthermore, it is maintained that CMHC's assisted rental program, designed to encourage private entrepreneurs to produce rental housing for families, does not for the most part result in ground-oriented units most suitable for families with children. The assisted home ownership programs operated by both senior governments do provide ground-oriented units but the Council notes that these units have tended to serve middle income groups to an increasing extent (CCSD, 1977, p. 157).

4.8 Summary

This review concludes with a brief description of what seem to be the most pressing unresolved questions that need to be considered in future housing research.

Since the early 1970s, government concern has focussed more on the growing subsidy requirement for housing by low income households. This raises several important questions:

1. Is it reasonable to expect a public and non-profit housing program to produce sufficient units to meet the financial need present among the elderly and other low income groups in the population, given the magnitude of current subsidy requirements?
2. What alternative approaches are available to deal with the housing-related financial problems of low income groups? Closely associated with this is the question of the degree of success which a housing allowance can be expected to achieve. It also depends on the extent to which Canadian housing problems are exclusively problems of affordability.
3. What is the appropriate role of government in the housing field? In Canada, 'housing policy', to a large extent, takes the form of governmental intervention in the private market, and thus the relationships between public bodies (at all levels) and the private market in the housing market are crucial. Equally so are the relationships between the federal, provincial and municipal authorities (Cullingworth, 1980, p. 10). The issues are founded in jurisdictional concerns but on a practical level, the principal issue is, how will the programs be financed?

Further research in these areas would develop a greater understanding of the major issues which affect the formulation of Canadian housing policy.

Notes to Section 4

(1) Dominion Housing Act, 1935, 25-26, George V, c. 58.

(2) The Rent Supplement Program, the Community Integrated Housing Program, and the Accelerated Family Rental Housing Program were started in Ontario. See Ontario Economic Council (1976) and Ontario (1975a) for a discussion of them. These programs are now dormant, except the Rent Supplement Program.

(3) Canada, Federal Task Force on Housing and Urban Development (1969, 19).

(4) S. Goldblatt (1966).

(5) Peter Barnard Associates (1975).

(6) MacMillan and Nickel (1974) provide some empirical support of the argument that public housing may not be the most efficient use of funds. The authors compare the costs of public housing and 100 per cent rental supplements paid to welfare recipients in Winnipeg in 1971. They made crude estimates that it was about 38 per cent less expensive to provide housing through rent supplements than through public housing: the annual cost of public housing was about $1.6 million for 817 households, while the annual costs for these households with 100 per cent rent supplements was about $1.0 million.

(7) For a discussion on equity, refer to Section 2, The Distributive Effects of Rent Regulation in this literature review.

(8) J. Barry Cullingworth (1980, 31).

(9) In government documents, social housing refers to the problems of "those households who lack the means to buy or rent housing that provides them with a reasonable standard of space and quality." (Canada Mortgage and Housing Corporation, 1981).

(10) In these programs, the provincial and municipal governments provide rent-to-income subsidies comparable to those in public housing in a portion of the dwellings provided by private developers or by non-profit corporations or cooperatives societies, usually up to 25 per cent of the units.

(11) Clayton Research Associates (1984a, 36) note that the average per unit cost of new projects in 1981 was $53,700, compared to an average per unit cost of $29,200 for existing projects.

(12) The Social Planning Council of Metropolitan Toronto (1984, xiii) explains that the low-end of market rents under the 1978 program are based on the non-controlled stock in surrounding neighbourhoods which in many instances represent rents well above the average for private market rents as a whole.

(13) For a discussion on alternative measures of affordability, refer to Section 3, Rental Housing Affordability in this literature review.

(14) In general, see K.F. Watson, F. Ermuth and W. Hamilton (1978).
On the British scheme, see J. Barry Cullingworth (1979, Ch. 8).
A useful summary of the American experience is Frieden (1980).

(15) The review of Manitoba housing allowance programs may be found in Minuk (1982).

(16) Falk (1982), the Social Planning Council (1982) and Canada Mortgage and Housing Corporation (1981) suggest that public and non-profit housing, for example, may be better supply programs.

(17) Marks (1984) states that some groups were unwilling to participate in the program.

> Welfare recipients, households headed by a member of a minority and single-parent households participated more than households with earned income, with a non-minority head, or with two spouses. The elderly had low participation rates, as did home-owners in comparison to renters. With the exception of the elderly, participation was thus higher among households that tended to have affordability problems. Some households preferred to live with their affordability problems and refused to move or upgrade their dwellings. The reasons most often given were ties to the neighbourhood and scepticism about finding a better unit; discrimination also hindered the mobility of the minority group members (p. 71).

(18) Struyk and Bendick (1981) state:

> Programs on the scale of those tested in EHAP -- including an entitlement program (universal coverage subject to eligibility and participation) in two markets -- will cause little if any inflation in rents for recipients and no inflation at all in rents for others (p. 15).

(19) In particular, see the studies by Canada Mortgage and Housing Corporation (1981) and the City of Toronto (1983).

(20) See, for example Smith (1971)

(21) For a detailed discussion, see Section 3, Rental Housing Affordability in this literature review.

(22) Data on the magnitude and costs of expanding assisted housing programs could not be found.

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SECTION 5: SECURITY OF TENURE

This paper reviews and summarizes literature relating to security of tenure. The aim is to identify and organize the material on this topic. An emphasis has been placed on relevant Canadian literature and on works published in the past ten years.

5.1 Recent Developments

Security of tenure did not gain recognition or importance in landlord-tenant law until the late sixties and early seventies. Rabin (1983) provides a broad analysis of why landlord-tenant law changed dramatically in that period. This study is specific to the United States but many of the doctrinal changes which took place in American landlord-tenant law have also made their way into Ontario's landlord-tenant law. Rabin (1983) notes that the doctrinal changes increased the degree of tenant protection, beyond security of tenure. Some of the more significant changes are the following:

1. The landlord now has the duty to repair all defects on the premises, regardless of when they arose and even if tenants had agreed to do so.

2. The retaliatory eviction doctrine grants broad protection to tenants.

3. Just cause eviction statutes are intact. These statutes permit a landlord to evict a tenant at the end of the lease term only if the landlord has 'just cause' to do so.

4. Some restrictions on condominium conversion (temporarily or even permanently barred) are now in place.

5. Self-help rememdies e.g. cut-off of a tenant's utilities, water and other service by landlords to obtain possession are now prohibited by law.

Rabin suggests that these doctrinal changes occurred as a direct result of developments, occurrences, attitudes and conditions that existed in the preceding decade. The late sixties was a period during which the general public developed an increasing sensitivity to social issues, became more perceptive and socially-aware and nurtured a desire to improve the quantity, quality and affordability of housing. Rabin cites a number of occurrences which came into play to reinforce these attitudes as well:

1. The civil rights movement created a climate of activism and became a dominant force which caused changes in landlord-tenant law.
2. Opposition to the Vietnam War reflected itself in unrest, in American art, culture, music and mores and consequently, in discontent with the way things were.
3. Institutional changes e.g. the establishment of legal services offices, staffed with idealistic and energetic lawyers participated in most of the test cases establishing tenants' rights.

In comparison, Rabin states that rent regulation legislation arose in response to an economic force -- inflation -- rather than to social or intellectual developments.

A number of Canadian studies address themselves to at least some aspects of the evolution of landlord-tenant law.

Policy Options for Continuing Tenant Protection (1978) notes that in the 1960s, it was obvious that the law was not functioning efficiently in resolving problems between landlords and their tenants. Part of the increasing awareness of the legal position of landlords and tenants was due to the large growth in the number of tenants, both in terms of their absolute numbers and as a proportion of the population. From 1961 to 1971 the number of tenants grew by 70 per cent from 483,500 to 825,000 in Ontario. During the same period, tenant households increased from 29 per cent to 37 per cent of all households.(1)

The first few sections of Cullingworth's paper, Security of Tenure (1981), describe and discuss the events which led to the provision for residential tenancy law in Ontario. Prior to the enactment of The Landlord and Tenant Act 1969, the law heavily favoured the landlord as against the tenant. For example, a tenant had to continue paying rent on a house which was completely destroyed by fire. The landlord was not required to warrant that the premises were fit nor that he would repair them at the start of or during the term of the lease. But, according to Cullingworth, social and economic changes during this period made this state of affairs unacceptable. Cullingworth does not identify the social and economic changes which took place, however, some of the changes in attitudes identified by Rabin for the United States are likely to have found their way into the Canadian environment.

The 1968 Ontario Law Reform Commission (OLRC) Report provides a thorough discussion on traditional landlord-tenant law in Ontario. The report reviewed a number of the consequences which the law prior to 1970 produced and identified a number of matters on which immediate legislative action was required. The Commission summarized the reasons for the law falling behind the needs of both landlords and tenants with respect to residential tenancies in the following manner:

> The common law of landlord and tenant, over the centuries, has not developed any legal philosophy based on a theory of vital interests. The single most important feature of landlord and tenant law is the existence of the leasehold "estate" of the tenant. The vesting of the estate in the tenant underlies the rather fixed nature of the law and has caused courts to determine the rights of tenants according to rigid land law principles, rather than in accordance with the more realistic development of contract and tort law which would apply in the absence of the estate theory...Landlord and tenant law is not in a consistently logical sense concerned with the interests of landlords and tenants and it has not even attempted to define them. In a sense, the common law of landlord and tenant is mechanical in that its conclusions as to the rights of the parties are based on the fact of the "estate", not on any realistic standard of vital interests which the law will endeavour to protect (OLRC, 1968, p. 10).

The Commission made a broad range of recommendations which formed the basis of The Landlord and Tenant Act in 1969. The main thrust of the Commission's considerations was to achieve "a fairer balance of rights and obligations between landlords and tenants". The Act did not provide for security of tenure, but it did provide new legal procedures for eviction. Section 107(1) provides that "unless a tenant has vacated or abandoned rented premises, the landlord shall not regain possession of the premises on the grounds he is entitled to possession except under the authority of a writ of possession obtained". The court can refuse an application for an eviction order on a number of grounds stated in the Act.

The Act also provided for the establishment, by municipalities, of Landlord and Tenant Advisory Bureaus. The functions of the Bureaus are to advise landlords and tenants in tenancy matters, to mediate disputes between landlords and tenants; to disseminate information for the purpose of educating and advising landlords and tenants concerning rental practices, rights and remedies; and to investigate complaints of conduct in contravention of the residential tenancies law.

Effective September 1, 1982, the Residential Tenancy Commission has assumed the responsibility for advising the public on all landlord and tenant matters, a function until then performed by the municipally operated and funded Landlord and Tenant Advisory Bureaus (Residential Tenancy Commission, Report to the Minister 1982/83, p. 5).

The 1972 Ontario Law Reform Commission Report investigated the operation of certain provisions of The Landlord and Tenant Act. The Commission expressed concern that some landlords were attempting to obtain possession by the withdrawal of essential services such as heating, gas, electricity and water. The Commission made the recommendation that the practice should be statutorily prohibited. This led to a 1975 amendment to The Landlord and Tenant Act, which prohibited self-help remedies by landlords as described above and also prohibited landlords from interfering with the "reasonable enjoyment of the premises for all usual purposes by a tenant..." [Section 107(4)].

The Ontario Ministry of Municipal Affairs and Housing report, The Impact of Rent Review on Rental Housing in Ontario (1982) briefly reviews the events which led to the revisions to The Landlord and Tenant Act in 1970 and in 1975.

All of the above Canadian studies state that, in one way or another, the revisions to The Landlord and Tenant Act, especially the 1975 revision, led to a dramatic increase in tenants' rights and a dramatic decline in landlords' rights. More importantly, part of the literature (OLRC, 1968, 1972; Ontario-MOMAH, 1982; Makuch and Weinrib, 1984) tends to support the idea that a transfer in rights was essential to achieve a fairer balance of rights for landlords and tenants. The following statement is indicative of the Ontario Law Reform Commission's concern:

> Due largely to their feudal origin and a preoccupation with proprietary interests, the rules governing the relations of landlords and tenants permitted the scales to be tipped substantially in favour of the landlords. Our concern was to redress that imbalance. (OLRC, 1972, p. 6)

In a similar vein, the Ontario-MOMAH study noted that:

> The revisions to The Landlord and Tenant Act which came into effect in 1970 started to redress the balance (between landlords and tenants). It provided for the first time a separate legal framework to govern residential tenancies. (1982, p. 140)

In their introduction, Makuch and Weinrib (1984) suggest that the 1970 amendments to The Landlord and Tenant Act:

> Can be seen as the law catching up to society's view of fairness and reasonableness in the relationship. The amendments were an attempt, in short, to alter the landlord and tenant relationship so that it would reflect society's view of what a reasonable relationship between landlords and tenants was. (p. 6)

5.2 Complementarity of Security of Tenure and Rent Regulation

There appears to be a general consensus that security of tenure and rent regulation must go hand in hand if either legislation is to be effective. The Impact of Rent Review on Rental Housing in Ontario (1982) presents the argument that the necessity of having both security of tenure and rent review are related to the concepts of economic eviction and of retaliatory eviction. With respect to the concept of economic eviction, in the absence of rent review, a landlord may force a tenant out of the rental unit by using a large increase in rent beyond the fair market value for the unit. In such a situation, security of tenure is ineffective in preventing economic eviction. Hence, the need for some type of regulation is argued to ensure security of tenure. With respect to the concept of retaliatory eviction, if rent review existed without security of tenure, landlords might penalize tenants who exercise their right to rent review by evicting the tenants.

Other Canadian studies have echoed similar arguments. The Ontario Law Reform Commission recommended that a form of rent regulation should be adopted alongside security of tenure, since the two are "opposite sides of the coin" (1968, p. 64). The Commission expressed the belief that:

> Security of tenure was essential for the enforcement of control on the price; experience is shown that as soon as security of tenure is let go, control of price disappears. (OLRC, 1968, p. 65)

In such a situation, Makuch and Weinrib (1984) state that:

> Security of tenure is coupled with rent control to meet the social welfare objective of affordable housing. (p. 31)

They continue:

> Security of tenure in a rent control system becomes one of the principal ways of preventing landlords from avoiding rent control and from attempting to undermine affordability of housing. (p. 31)

In the Report on Landlord and Tenant Relationships (1973), the British Columbia Commission recommended that a system of tenant security be implemented in the province. The Commission also put forward the idea that the institution of a rent regulation system might be required in order to protect tenants from being dislodged by exorbitant rental increases.

One debate which has come to the fore regards the current balance of property rights between landlords and tenants. As already mentioned, there appears to be a general consensus that the establishment of security of tenure has produced a more equitable distribution of property rights. At the same time, part of the literature has expressed the need to provide adequate protection of the property interest of landlords. This particular issue has generated some discussion in papers by Gorsky (1977), Ontario-MOMAH (1978; 1982), Cheung (1974) and Rabin (1983).

Gorsky (1977) provides a comprehensive legal interpretation and evaluation of the 1975 amendments to the Ontario Landlord and Tenant Act. Of particular interest is his identification of a number of deficiencies in the Act which should be remedied. Gorsky submits that landlord frustrations brought about by lengthy delays in obtaining and enforcing a writ of possession can become a source that undermines the purposes of the Act. He contends that the Act as it exists fails to protect landlords from delays since Section 106(6) does not take into consideration rent which accrues after the commencement of the proceedings. Consequently, Gorsky maintains that in court cases where landlords are successful, "additional losses may be suffered by landlords where the judge delays his consent to a writ of possession" (1977, p. 688). Gorsky's main point is that, the law will be judged seriously deficient by landlords, unless they can be assured that they will be able to recover possession for just cause without unwarranted delays.

Gorsky also identifies some deficiencies in the procedures established by the Act. He strongly recommended the establishment of a landlord-tenant tribunal which would hold sittings at night and during the day(2). Hearing dates should be flexible so as to accommodate the needs of the parties. A greater use of on-site inspection by the tribunal may be in order.

The 'Green Paper', Policy Options for Continuing Tenant Protection (1978), reiterates the statement that 'tortuous procedures' for eviction have become burdensome for landlords. This group recommended that a simplified more expeditious procedure for dealing with rent arrears and eviction was desirable.

A few studies have expressed the concern that the landlord-tenant law has not only redressed the imbalance of rights, but has tipped the balance in favour of tenants.

The Impact of Rent Review on Rental Housing in Ontario (1982) identifies legal arguments emerging from the United States which take the position that security of tenure and rent regulation may be a violation of the landlord's constitutional rights to property (See Chapter 8). While these constitutional arguments would not be applicable within the Canadian Constitution, the legal philosophy involved is of interest.

Chief Justice Tauro of the Supreme Court of Massachusetts, in a case involving eviction for the purpose of renovating a unit, took the position that:

> When eviction controls operate to deprive the landlord of any alternative use of his property for an indefinite period of time, the application of such controls constitute a taking. (Ontario-MOMAH, 1982, p. 144)

Closely related to the 'taking-issue' discussed above is Cheung's theoretical analysis of the effect of price control (or regulation) on private property. In his article, Cheung (1974) enunciates the economist's conception of private property. The owner must have three sets of rights to an asset or good for it to be private property:

> First is the exclusive right to use, or to decide how to use, the good; this may be viewed as the right to exclude other individuals from its use. Second is the exclusive right to receive income generated from the use of the good. Finally, the right to transfer, or freely alienate, its ownership to any individual the owners sees fit includes the right both to enter into contracts with other individuals and to choose the form of such contracts. (1974, p. 57)

In the context of rental housing, the interpretation of these conditions is as follows: the income generated by the rental building belongs to the landlord. Landlords and tenants will make contractual arrangements concerning the conditions of a tenancy and certain rights will be assigned to the tenant. The contract will specify the rights and obligations of both parties to the agreement. Cheung argues that rent regulation violates the second private property condition for it regulates rents and hence income in some way. However, the effects may be mild because the restriction of rents is not as great as under strict rent regulation. Also, eviction controls (a provision in security of tenure legislation) violate Cheung's first and third necessary conditions.

In a Canadian context, concern has been expressed that rent regulation and security of tenure have led to further erosions in property rights. Ontario-MOMAH submits that the rise of both restrictions on conversion to condominium use and on demolition in many municipalities can be seen in this light (1982, p. 144). Rabin's study attempts to explain the rise in such legislation. Rabin (1983) submits that the rise in legislation related to the supply of rental housing has been a direct result of the increasing political strength of tenants. He suggests that rent regulation and condominium conversion legislation reflect the interests and voting power of the current tenants in a community:

> The parallel between rent control legislation and condominium conversion legislation is obvious. In both cases tenants who are residents in their jurisdiction vote their own interest by limiting the rents they will pay and by protecting their tenant position by limiting conversions. (Rabin, 1983, pp. 52-53)

Other authors such as Marcuse (1978), Albon (1980) and Cullingworth (1981), lend support to the idea that rent regulation and security of tenure have benefitted a particular subgroup of tenants with political and economic clout.

The cited literature exposes deficiences in Ontario landlord-tenant law. However, the debate on the issue of the extent to which landlords' property rights should be limited is far from complete. Two points of view emerge in this debate. The Ontario-MOMAH study (1982) holds the view that:

> Disputes over the proper definition of property rights lie at the very core of the debate over security of tenure in rent review. (p. 145)

As a consequence, the debate relates to views of the legitimacy(3) of private ownership in providing rental housing (Ontario-MOMAH, 1982, p. 145). In contrast, Makuch and Weinrib (1984) find that the Ontario-MOMAH statement:

> Presupposes a proper legal allocation of rights between landlords and tenants rather than a socially achieved consensus on what rights should be. (p. 6)

They continue:

> It is therefore difficult to answer any question that asks to what extent the property rights of landlords should be limited in a legal sense. There is no real limit that the law can impose. It is a matter of social values and beliefs. (p. 6)
>
> ...It is clear...that security of tenure is not a legal problem in the sense that the law can give definite answers to the questions of security of tenure. (p. 7)

A number of authors lend support to the view expressed by Makuch and Weinrib. Oosterhoff and Rayner (1979) emphasize that:

> Security in a society has moved from viewing landlords as having an absolute discretion to control residential realty to one in which the tenant's desire for security can only be undercut by reasonable action, not merely by an appeal to "property rights". (Makuch and Weinrib, 1984, p. 12)

Similarly, Reich (1964) expresses the view that:

> Property and liberty are separable things; that there may, in fact, be conflicts between "property rights" and "personal rights". (p. 771)

5.3 Tenant Concerns

Some of the literature identifies a broad range of issues which relate tenants' concerns to security of tenure. The issues can be divided into the following categories:

1. The economic costs associated with security of tenure;
2. The bargaining position of tenants;
3. Alternatives to security of tenure in providing protection to tenants.

5.3.1 Economic Costs

Studies by Ontario-MOMAH (1982) and Rabin (1983) present the idea that security of tenure may impose costs on tenants themselves. Ontario-MOMAH (1982) takes the approach that the costs to tenants are related to the concept of security of choice. Security of choice relates to the ability to move into another unit for one reason or another. The idea raised is that, if security of tenure and rent regulation serve to reduce the ability to move, then security of choice would be diminished and this would offset the advantages of the programs to tenants. In Ontario, mobility rates are still fairly high(4) so that it would seem that security of choice has not been seriously undermined by changes in landlord and tenant law.(5)

Rabin (1983) presents the mainstream analysis which proposes that, regardless of intent, the changes in the landlord-tenant law would hurt tenants more than it would help them. Underlying the mainstream theory is the presumption that the lower income groups will lose most by security of tenure. This group of scholars argue that each increased tenant protection and landlord duty must ultimately be paid for by the tenants. Those least able to pay increased rents will lose more than they gain from additional protections. Mainstream analysts predicted that the increased legal rights won by tenants in the early seventies would worsen the housing conditions of the poor. Rabin identifies four statistics which seem to support the prediction of mainstream analysts that increased tenants' rights would cause a shortage of rental housing with a concomitant increase in average rents. They are:

> 1. Tenants' average rent to income ratios increased significantly;
> 2. Vacancy rates decreased;
> 3. The rental housing business became less profitable;
> 4. Construction of unsubsidized rental housing units fell, relative to construction of other housing. (1983, p. 58)

However, Rabin argues that none of these statistics, properly interpreted, indicate a growing shortage of rental housing. Rabin attributes the rise in rent to income ratios and the falling profitability and construction of rental housing to a reduced demand for rental housing by the more affluent segment of housing consumers. As well, he questions the validity of the vacancy rate as a measure of the tightness in the housing market. To many observers, a falling vacancy rate suggests increasing housing shortage. In Rabin's view, this interpretation of vacancy rates is erroneous. He proposes that vacancy rates serve as a measure of the average gap between landlords' asking prices and the market equilibrium price. Lower than normal vacancy rates indicate asking prices that are lower in relation to demand than they were at some time or place, taken as a norm. Rabin contends that during the seventies, landlords chose to charge existing desirable tenants below market rates in an attempt to keep them and to avoid the necessity of covertly using impermissible criteria in choosing new tenants.

It is difficult to judge whether increased tenants' rights, including rent regulation legislation, have led to a shortage of rental housing except by empirical inquiry.(6) Rabin's presentation of the mainstream theory is fruitful in elevating the topic of the distributional impacts of security of tenure into prominence.

5.3.2 Tenants' Bargaining Position

Some debate has emerged on the limits to the effectiveness of rent regulation and the inherent weakness of the bargaining position of tenants. Cullingworth (1981) identifies a number of opposing views on this subject. Cullingworth's paper contains a discussion on issues dealing with the politics of rent regulation. One view holds that rent regulation is valuable as an issue around which people can organize and can contribute to 'consciousness-raising' about the workings of the housing system.

However, Cullingworth notes that social attitudes may hamper the political strength of tenants. According to Cullingworth, a 'social distance' between the judiciary and tenants has emerged as a political element in recent years. Cullingworth makes useful reference of a study of the Detroit Landlord-Tenant Court by Mosier and Soble (1973). The main conclusion, reached by Mosier and Soble in their study of eviction cases filed and tried during 1970 and 1971, was that the objectives of the landlord-tenant legislation were not met in that jurisdiction. They argued that the disparities in help given to landlords and tenants indicated a bias of the court toward the landlord. The authors suggest that the bias exists because judges and court personnel share more common values, perceptions and socio-economic backgrounds with landlords than with tenants.

It is difficult to judge the significance of this hypothesis for Ontario's landlord-tenant court system and rent review. A number of Canadian studies have noted a reluctance on the part of tenants to use the courts in Canada.(7) This could be partly the result of tenants' frustrations with court procedures as noted by the 'Green Paper'(8) or it could be partly due to the popularity of the conciliation machinery as noted by the Ontario Law Reform Commission.(9)

Some authors like Garrity (1969) express skepticism of the potential effectiveness of bargaining and hold the view that bargaining power is positively related to economic power. One exception could be organized tenant groups which, Cullingworth (1981) asserts:

> Given a reasonable degree of security of tenure and an adequate legal framework as now exists in Ontario, there seems no prima facie reason why tenants' organizations could not become effective bargaining units. (p. 78)

5.3.3 Alternative Policies

The concept of bargaining has opened the door to alternative systems of protecting tenants' rights. A number of papers present innovative solutions to the problem of resolving landlord-tenant conflicts.

In his article, Rose (1973) criticizes the traditional landlord-tenant relationship as being outmoded and offers a remedy called 'mutual ownership'. Rose submits that mutual ownership (in the form of co-operative, condominium or home association) would eliminate conflict in the landlord-tenant relationship since both parties would work cooperatively as a result of the common economic interests vested in the property.

Shreiber and Tabriztchi (1976) present a different solution to the problem of resource allocation of housing supply. The authors argue that the problem of housing misallocation can be solved by making the right of a rent regulated tenancy marketable. In such a situation, tenants can sell to whomever they please. The proceeds of the sale (called 'key money'), however, are divided between the outgoing tenant and the landlord in the ratio of two to one. Such a system, the authors submit, encourages the maintenance and improvement of rent regulated housing since tenants would have more incentive to improve and maintain their own apartments.

> If this formula is adopted, landlords will have less to gain from a shift in tenants and tenants will not have to forfeit the whole value of the improvements that they added to the apartment -- they will always be able to recoup two-thirds of it. (Shreiber and Tabriztchi, 1976, p. 520)

Cheung (1979) chose to examine Hong Kong's system of rent control and its development because of its exceptional legal character. In Hong Kong, a 1968 provision in the law enabled landlords and tenants to enter into an agreement with compensation for the surrender of controlled tenancies. Under this original provision, the vacated premises remained subject to control, but a 1973 amendment provided that, where an agreement for surrender was made, the premises became automatically excluded from control. (It should be pointed out that the payment of 'shoe' or 'key money' by landlords to vacating tenants had been a tradition long before the ordinance was ever considered.) Much more significant was an amendment of 1955 which provided that exemption from rent regulation orders (which previously had been granted only in cases where the 'public interest' was involved) should enable a Tenancy Tribunal to require payment of compensation to the affected tenant. Cheung comments that this "amounted to granting the Tenancy Tribunal the power of eminent domain in reconstruction proposals, and all subsequent exemption cases included terms for monetary compensation in an amount determined by the Tribunal" (Cheung, 1979, p. 40).

Cheung suggests that many of the legal developments in the Hong Kong rent control system were necessitated by the population pressures unique to the colony. As well, in Hong Kong there is no fixed price convention; people bargain over everything. These special circumstances may explain why similar provisions in other jurisdictions have not been found.(10)

Spivak (1980) describes a Long Island community's method of negotiation in resolving rent and lease conflicts. This community was an apartment complex located in an area in which rent regulation law had not been adopted. At issue were the rent levels and short leases proposed by the landlord. Tenants were dissatisfied with the proposals and petitioned for adoption of rent regulation. However, a compromise was reached to the benefit of both tenants and landlord. Some of the features of the agreement were:

1. Future rent increases would follow the published guideline rates as established by the rent guideline board of the county. Utility 'pass throughs' would be allowed if the board approved them for the county as a whole.
2. Present tenants would be offered one-, or two- or three-year lease renewals. New tenants would be offered one-year leases only.
3. Rents for new tenants would be determined by the marketplace, thus eliminating any controls on apartments that would become vacant.

4. The rent charged senior citizens, whose low income qualified them for a property tax reduction, could only be increased by one-half of the allowable rate.

(Spivak, 1980, p. 166)

Cullingworth (1981) notes that the area concerned appears to have been a settled, middle-class and articulate community. That raises the question about whether it would have been easily possible to achieve a similar compromise in a different type of community (or one in which rent regulation had already been imposed).

5.4 Summary

This review has examined and summarized issues relating to the current structure and potential impacts of security of tenure. A number of general points can be derived from the literature:

1. Security of tenure and rent regulation must co-exist if the perceived intent of both pieces of legislation are to be met.
2. Security of tenure has become an accepted doctrine in landlord-tenant law. Security of tenure legislation has offered some protection to tenants in terms of a certain degree of control and security over their housing.
3. Security of tenure has provided a basis for organizing and common action. In general, present tenants have become more affluent, better educated and more politically sophisticated than tenants in

past decades. These changes have brought higher expectations of fair treatment and a willingness to respond to a denial of their rights.

4. There is a general belief that landlords' profits must be balanced against tenants' needs.(11)
5. There seems to be a general impression that rent regulation and security of tenure have reduced the incentive on the part of entrepreneurs to participate in rental construction.

More research on particular issues related to security of tenure could be fruitful -- for example:

1. The evaluation and desirability of current security of tenure provisions for the protection of tenants' rights;
2. The implications of increased tenants' rights for landlords' property rights;
3. Feasible alternatives to security of tenure, as measures for the protection of tenants' and landlords' rights;
4. The evaluation of costs which may become imbedded in rents as a result of increased security of tenure.

Notes to Section 5

(1) The statistics were compiled from Census data 1961-1971. The historical trends in the number of tenant households and their proportion of all households are depicted in Chart 3-1 in Ontario, Ministry of Consumer and Commercial Relations (1978, 21).

(2) Gorsky (1976-1977) states that, merely changing the forum for settlement of landlord and tenant disputes is unlikely to bring significant improvement in the enforcement of the rights and obligations contained in the Act. The forum must also provide for an adequate, well trained staff in the law as well as in the technique of mediation and conciliation (footnote 105, p. 704).

(3) Legitimacy can be loosely interpreted as allegiance to the interests of state concerns. In this particular case, the legitimacy question is focussed on the ideological issue of whether the private market system can be relied upon to provide rental housing. Marcuse suggests that "if the private sector is unable or unwilling to do the job, subject to socially necessary forms of regulation ...new forms of housing finance, ownership, and control must be created to more adequately serve people's housing needs" (1978, 30).

(4) According to the October 1981 and January 1983 Rental Market Surveys, the mobility rate was 29 per cent in Toronto. From Ontario, Ministry of Municipal Affairs and Housing (October 1981 and January 1983).

(5) For a more detailed discussion on mobility rates, refer to Section 2, Distributive Effects of Rent Regulation in this literature review.

(6) Determining a causal relationship is hampered by the difficulty of isolating the impact of rent regulation or tenants' rights legislation while controlling for the impact of contributing factors.

(7) The Ontario Law Reform Commission noted that evidence from Canada, the United States and Britain demonstrated the reluctance of tenants to use the courts. See Ontario Law Reform Commission (1968, 41).

(8) See Ontario, Ministry of Consumer and Commercial Relations (1978).

(9) Ontario Law Reform Commission (1968, 41).

(10) Cullingworth (1981, 62) suggests that in Britain, a similar provision may exist but in a very different

guise, where reconstruction involves dispossession of the landlord - at minimal compensation for 'slum' property - and public authority rehousing for the tenant.

(11) For an analysis of this topic, see Knetsch, Kahneman and McNeill (1984).

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SECTION 6: THE POLITICAL ECONOMY OF RENT REGULATION

6.1 Introduction

During the past two and one-half decades, various theories have emerged to explain why governments intervene in the economy. The purpose of this section is to briefly review the development of major political economic theories of regulation and to illustrate the effects of a number of these theories on housing policy. In particular, rent regulation experiences in Ontario and the United States are reviewed in separate subsections.

6.2 Recent Theories of Regulation

Cairns (1980) indicates that there are three stages in the understanding of the rationales for and the effects of regulation. These are the public interest view, the private interest view, and the 'new dynamic' view (Cairns, 1980, p. 6).

The public interest view(1) is the traditional explanation for the use of regulation in government. As Cairns and Green state:

> It is used in an attempt to correct perceived "market failures", i.e. to eliminate gross failures of one or more of the assumptions upon which the competitive model is based and which are necessary for unregulated market achievement of a social optimum. (1979, p. 3)

Prior to the 1970s, many economists regarded regulation as being motivated by concern for a vaguely defined 'public interest'(2) and strongly grounded in welfare economics. Cairns explains:

> Because of market failures, the market might, in some circumstances at least, be viewed as either fragile or impotent in maximizing social welfare. These problems, it was thought, could be eliminated by the regulatory actions of benevolent government policemen. (1980, p. 9)

However, faith in the public interest view weakened toward the end of the 1960s and a new view of government legislation in the economy emerged to vigorously challenge the public interest view. The private interest view(3) focussed on:

> The observation that regulation often was sought by and benefitted a small group of individuals (a private interest) rather than the majority of individuals (the public interest). (Cairns, 1980, p. 6)

Stigler, the leading proponent of this view, combined politics and economics to develop his demand and supply theory of regulation. Stigler (1971) placed the emphasis on interest groups seeking regulation and implied that (among other things) politicians served to supply regulation (Cairns and Green, 1979, p. 3).

> That is, private parties seek, or demand regulation for the purposes of protecting or creating entrenched positions. Politicians seeking the support, or pacification, of interest groups supply the necessary legislation. (Cairns and Green, 1979, p. 2)

The private interest view arises from considerations in 'positive' economics and the analysis of economic incentives (Cairns, 1980, p. 23). In general, positive theories of government action(4) tend to focus on political factors. Therefore, as noted by Stanbury and Thain:

> The role of interest groups, the motivation of politicians and the behaviour of marginal voters (or voters in marginal constituencies) are central in positive theories of government intervention. (1985, pp. 1-5)

Implicitly underlying the private interest view is 'rent seeking' behaviour. Rent seeking as defined by Hartle is:

> An investment of real resources (time, money, expertise) by individuals or interest groups in obtaining favourable (or avoiding unfavourable) government decisions. These decisions involve the redistribution of income/wealth rather than the creation of income/wealth. (1984, p. 34)

Due to the significance of rent seeking to the private interest theory, Subsection 6.5 is devoted to a review of recent literature on rent seeking.

Cairns sees the relevance of 'rent creating' analyses of regulation to Canada, however, he regards the private interest view as 'simplistic' because it "captures neither the great public need for regulation, given the increasing complexity of modern life, nor the full flavour of the greater part of regulation" (Cairns, 1980, p. 7).

Cairns proposes another approach, the 'new dynamic' rationales on regulation which is:

> A view of the market, not as an all powerful _deus ex machina_, but as a common property resource and an institution of society, subject to overloading and occasional breakdown. Thus, competition may be one regulatory device, but it should not be viewed as the only efficient one. (1980, p. 7)

Cairns suggests that the new dynamic rationales:

> Emphasize both the imperfection and the power of the market in a present-day mixed economy. They reflect more realistic perceptions of the abilities and motivations of politicians and bureaucrats; such improved perceptions are important to the goal of improving the functioning of markets, given their power. (1980, p. 58)

Thus, a wide variety of actors with different motivations are seen to impinge on the regulatory process. The main conclusion reached by Cairns is that:

> Direct regulation is not as simple as it may appear, especially as it appears in some of the theoretical depictions provided by economists. Regulation is not only a market phenomenon; nor can it be construed as a single action by a government intervening in the marketplace having a well-defined and easily analysed impact. Rather, it is an historical-political process, evolving, ever in disequilibrium. (1980, p. 78)

6.3 Political Economy of Rent Regulation in the United States

This section reviews Marcuse's analysis of the determinants of rent regulation as state policy. Marcuse (1978) introduces three theories to explain the rationales for and effects of regulation. The first is the theory of the benevolent state. This theory emphasizes that the purpose of rent regulation is to achieve fairness, with respect to welfare maximization, to both tenants and landlords. In situations where the parties are prevented from achieving by themselves that fair level of rents, the intervention of government to achieve fair rents and thus protection of the public interest is necessary.

According to Marcuse, the assumptions of the theory of the benevolent state are flawed. The underlying assumption of the theory is that 'fair' equals 'free market'. Yet Marcuse argues that "the free market is unlikely to produce housing for those unable to afford it with the means with which that market system provides them" (1978, p. 2). Another assumption of the theory is that the state only intervenes in the rental relationship through rent regulation, and then only benevolently. However, Marcuse notes that:

> In fact, the state is intimately involved with all aspects of rental housing, from subsidies to participants in its construction through infrastructure expenditures, to the legal framework within which landlord-tenant relations are established and conducted, through the impact of tax laws and fiscal and monetary policies on costs, profits, and rent levels, to welfare programs, code enforcement (or its lack), and the provision or withholding of public facilities and services. No underlying benevolence unifies these policies. (1978, p. 2)

Marcuse introduces an alternate approach to housing issues, called the Malevolent Interests Theory:

> It holds that the problems of housing are essentially caused by the rapaciousness of landlords, the greed of banks, the venality of real estate interests, the heedless drive for profits of contractors and developers. (1978, p. 2)

The malevolent interests theory implies that special interests operate continually to influence legislation and the execution of public policies, and that they do so hoping to reap benefits.

However, Marcuse views the malevolent interests theory as an incomplete explanation of housing policies or conflicts. In particular, he emphasizes that resting the whole case for rent regulation on the malevolence of individuals (many of whom are manifestly not evil) weakens the case considerably. Furthermore, while the accusation of malevolent interests may stimulate short-term organization and incite direct action among proponents of rent regulation, it also may impede the development of effective mass action. As Marcuse explains:

> All proponents of rent control do not advocate it for the same reasons: middle class tenants have quite different interests from poor tenants, are served by quite different formulas and procedures, tend to adopt quite different strategies, and pursue quite different goals. (1978, p. 4)

A third approach, the Approach of Political Economy, is introduced as a more accurate explanation of the determinants of rent regulation as state policy. In this approach, major government policy decisions on housing, and on rent regulation, are determined by factors outside the housing sector, centering around issues of accumulation and legitimation, economics and politics, profits and power.

There are a number of ways in which the activities of the state may be categorized. According to Marcuse, the categories 'accumulation/legitimation' are perhaps the most widely used within the framework of political economy today. The dichotomy they represent is crudely analogous to the dichotomy between the economic and political sphere. Marcuse states that it parallels the distinction between social investment and social expense. Legitimation can be loosely defined as the processes by which the state acts to reinforce existing interests politically, economically and socially. Marcuse defines the accumulation process as the 'economic processes of the system'.

The range of accumulation and legitimation policies are set along a continuum:

accumulation :
exploitation → rationalization → redistribution

legitimation :
repression → ideological → delegitimation

Marcuse suggests that rent regulation in its most typical American form (what is later called the fair return model) is at the centre: rationalizing the pricing of rental units and supporting the assumptions of the legitimacy of a market economy (1978, p. 5).

Part II of Marcuse's paper examines the relationship between rent regulation and accumulation. Marcuse comments on how a hierarchy of concerns in the sphere of accumulation works itself out in the detailed formulations of rent regulation laws and their application in practice. The hierarchy of concerns are:

- the needs of production and accumulation as a whole;
- the profits of private real estate interests;
- the housing expenses of middle-income tenants.

Only major aspects of each concern are discussed in this review.

The Needs of Production:

Rent regulations were first adopted during the First World War in the United States and specifically designed to accommodate the influx of war workers and military personnel in the major cities without adverse political consequences. In broad terms, the need to house workers newly required by expanded production was the most immediate and direct service of rent regulation during the war period. Beyond that, rent regulation was necessary to avoid or control inflationary pressures.

Marcuse notes that apart from the wartime period, when rent regulations were imposed in the interests of production as a whole, there is no evidence (at least in the United States) of any direct relationship between controversies over rent regulation and the production of the accumulation process.(5)

Private Real Estate Interests and the Details of Rent Regulation Laws:

In this concern, the issue involves only the distribution of income between landlords and tenants. Marcuse introduces a variety of formulas which are used to establish rent limits under rent regulation, in order to show the exact nature of the impact on the economic position of landlords. The relevant categories are:

i) 'Fair return' formulas - under which rents are fixed so as to provide a 'fair return' to the landlords on investment, on equity or consistent with past returns, or on some similar base. According to Marcuse, this formula effects no redistribution, and may even benefit landlords.

ii) 'Market' formulas - under which rents are fixed so as to be consistent with what they would be were a free market in operation, based on comparable rents, on standards established by size, amenity and location, by past rental levels, or on some similar base. Marcuse states that this formula effects no general redistribution and may, at most, limit returns on exceptional cases to those prevailing in the market generally.

iii) 'Tenant hardship' formulas - under which rents are fixed in relation to tenant income, on the basis of percentage of earnings, welfare standards, changes in the cost of living, or on some similar base. This formula, if administered effectively, may provide for limited redistribution from landlord to tenant.

Rent freezes, depending on their level, can come in any category.

The fair return formula, regarded by Marcuse as the least redistributive of all, is the most widely used in the United States. Three features, characteristic of the fair return formula are:

1. A formula to provide for a fair return;
2. Automatic pass-through of operating cost increases;
3. Adjustments permitted for individual hardships to landlords.

These characteristics are used to set the rent levels which yield to owners a fair rate of return for such units.(6)

In Marcuse's opinion, the net result of fair return rent regulation ordinances in the sphere of accumulation is negligible:

> They tend to even out the market, to bring temporary or isolated high rents more into line with prevailing ones. They rationalize the market for residential rental properties. They even have some advantages for landlords

> that may arguably contribute to increased net profits. The rents fixed under them achieve a status of a legal sanction, that makes individual efforts to bargain for lower rents more difficult. The vagaries of the atomistic free market are reduced; while upper limits are set on current profits, lower limits are also de facto established. (1978, p. 15)

Marcuse concludes that the impact of fair return rent regulation ordinances in the middle income market is essentially neutral and rationalizing, and has no effect on low income rents.(7)

Marcuse provides some fragmentary evidence of the essentially neutral rationalizing function of rent regulation in the middle income markets; in a comparative study of rent levels in Vancouver, with a fluctuating history of rent regulations over five years with Toronto, without regulation, rents were higher in the former than the latter.

Finally, Marcuse suggests that the needs of private economic interests are consistent not only with the fair return model of rent regulation but also are consistent (depending on the specific historical circumstances), with even the most stringent tenant hardship models.

> Rent controls are as likely to serve more smoothly to integrate the functioning of the private landlord with the needs of accumulation of the economy as a whole, as they are to redistribute normal rental market profits from landlord to tenant;... (Marcuse, 1978, p. 17)

Part III of Marcuse's paper examines rent regulation in the context of the political sphere. A hierachy in this sphere is laid out as follows:

- threats to the stability of the system as a whole, real or perceived;
- political conflicts among major parties, classes, and interest groups within the system, outside the housing sector;
- immediate profits and the quest for long-term legitimacy by private residential real estate markets;
- pressures of middle-income tenants for a better housing program;
- demands of low-income tenants for improved housing.

These are forces affecting rent regulation as they are reflected in the political sphere. Marcuse examines them in the light of selected periods of the history of rent regulation and the conflicts surrounding them.

Marcuse identifies three determinative factors which combined to produce post-World War I action on rent regulation in New York: concern by the state with the stability of the system, broad political conflicts in which rent regulation was a subsidiary issue, and the militant demands of those suffering from the housing shortage. A fourth factor, the influence of middle class housing pressure grew as time went on.

In the 1930s, the issue of legitimation was clearly more critical than in 1919. In New York, the adoption of tenant hardship, rather than the fair return, formula for rent regulation ceilings marked the low income orientation of the organization. However, Marcuse notes that the low income oriented efforts at rent regulation had limited success. He attributes the failure of tenant demands in the 1930s to the disjunction between low income and middle income housing concerns.(8)

The World War II and post-war history of rent regulations in both the United States and Europe saw the adoption of fair return formulas. Marcuse suggests that the history:

> Bears out a general pattern in which the overriding needs of production in wartime give way to legitimation concerns in the immediate post-war period; once assuaged, the fortunes of rent control hinge entirely on the shifting participation of middle-income and lower-income tenant pressures, and are dominated by developments in the general political sphere, rather than within the housing sector. (1978, p. 22)

A new wave of mass action on rent regulation occurred in the United States from 1968-1976.(9) Although the action surged upward from 1969-1971, the substance of rent regulation lost its weight by 1975. That is, tenant groups were unable to match the strength of the "opposition" which consisted of builders of new housing, marginal landlords, condominium converters and landlords. The latter group was successful in obtaining vacancy decontrols, broad pass-through formulae and large blanket increases.

The question of what role rent regulation is likely to play in current and future political and economic conflicts is dealt with in the last section of Marcuse's paper.(10)

In Marcuse's opinion, the potential of rent regulation for major impact consists of a number of positive characteristics.

1. It deals with housing, an important problem for individuals and families in their daily lives.

> Housing is the single largest expenditures in the household budget. Its characteristics affect the quality of individual life directly and significantly.
>
> 2. The market, and policies dominated by market forces, are unlikely to produce socially desirable housing arrangements.(11)
> 3. Rent regulation, among housing issues, is one of the most likely to generate mass involvement. Because rent regulation is directed at government action, the individual's home is not at risk; because it will directly and immediately affect his or her monthly rent, its potential benefit does, however, strike home. It is local and direct, and the issues are comprehensible in the short run to everyone. It suffers from a lack of acceptability in conventional politics, however, once legitimately entered onto the political arena, it is likely to be a strong issue.
> 4. Coalition building is feasible for rent regulation. Low income and middle income tenants have a common interest in bringing rents down. It is a true common interest, not merely a coalition built on trade-offs and reciprocity.(12)
>
> (1978, pp. 25-26)

In his closing statements, Marcuse remarks that the more radical implications of rent regulation "arise from what it cannot do, not what it does" (p. 30). Marcuse identifies aspects within the confines of rent regulation that will tend to broaden the issues:

- using tenant hardship as the determining criteria for setting rents, rather than returns to landlords;
- acknowledging and highlighting the limitations of rent regulation;
- developing programs that will increase the redistributive impact of regulation;
- using the anomalies produced by rent regulation to highlight the irrationalities and counter-social results of the private market in housing;
- linking rent regulation with the need for immediate subsidies and ultimately 'housing in the public domain'.

6.4 Evolution of Rent Regulation in Ontario

Some people hold the opinion that rent regulation in Ontario has evolved into a complex system as a result of changes necessitated by real problems. In Subsection 6.1, a reference is made to a statement by Cairns, to the effect that, "regulation is a historical-political process, evolving, ever in disequilibrium". With this statement in mind, we turn to an analysis of the evolution of rent regulation in Ontario. The purpose of this section is to review, in chronological order up to December, 1985, the circumstances and events which have influenced the changes and revisions in rent regulation legislation in Ontario since its introduction in 1975. A summary of these features ends this subsection.

A detailed analysis of the events which led up to the introduction of rent regulation in Ontario may be found in Stanbury and Thain (1985). Stanbury and Thain provide a thorough account of the social, economic and political forces that brought about the imposition of rent regulation in Ontario in 1975. As they say:

> The objective of the case study is to understand _why_ the Progressive Conservative Party,..., in the context of an election campaign, promised to introduce a form of rent regulation. (1985, p. 5-1)

The theoretical framework used to analyse the events and actions leading up to rent regulation draws heavily upon three factors: the changes in underlying economic conditions; the actions of other governments; and the role of ideology, as a constraining factor, in influencing the policies a political party will offer voters in the hope of obtaining votes. (Stanbury and Thain, 1985, p. 5-2)

Several charts, identifying the guideline changes which have occurred since the beginning of rent regulation in Ontario, are provided at the end of this section.

The rent review program was conceived as a temporary program that was to expire on July 31, 1977. When it was first enacted in 1975, the Ontario Liberal Party described it as "a temporary stop-gap measure...to protect tenants from excessive rent increases." The Party identified 'three essential needs' of Ontario's tenants: protection against excessive rent increases; adequate level and quality of maintenance; and assured security of tenure. The Liberals emphasized that because of low vacancy rates in several areas, rent regulation should continue for two more years "in order to protect tenants against unreasonable or unfair rent increases." The Ontario government document, Policy Options for Continuing Tenant Protection provided a similar rationale for rent review legislation:

> Given a strong level of demand and slow down in production, vacancy rates across Ontario were at low levels in 1975... With tight housing markets, as indicated by low vacancy rates and rapidly increasing costs, rent levels were subject to considerable upward pressure... Accentuating the higher-than-normal rate of average rent increase was the concern over well-publicized cases of much higher increases... Public attitudes toward inflation in general were also exerting pressure on governments for a decisive response... In the context of this environment of public attitudes, both federal and provincial governments acted to introduce controls on inflation. (1978, pp. 14-15)

On November 6, 1975, in response to public demand and pressure from the other two political parties the Ontario Government introduced legislation establishing the Ontario Rent Review Program in support of the federally initiated Anti-Inflation Programs. Both measures were enacted into law shortly thereafter.

The Residential Premises Rent Review Act, 1975 was concerned with the amount by which a landlord may increase his rents because of increased costs and financial loss. The cost pass-through principle, in which rents could be increased only to the extent that costs have risen, was (and still is) the core of the rent review program. It was assumed that there would be an annual increase of some amount: the landlord was allowed to raise his rents by not more than the statutory increase (8 per cent initially) without having to burden himself or the regulatory system with the cost and effort of an application.

The retroactive features in the 1975 legislation were aimed at rectifying situations of abnormal increases in the period immediately prior to rent review. According to the 'Green Paper',(13) in this period, some landlords had increased rents drastically in order to have a high rent level before rent review imposed restraints. Other landlords had increased rents little or not at all. The legislation thus provided a "levelling out of such situations in subsequent reviews" (Ontario-Ministry of Consumer and Commercial Relations, 1978, p. 16).

The rules covering withdrawals of services to tenants were put in to minimize the occurrence of such withdrawals on the part of landlords. The Green Paper noted:

> A landlord whose rent levels were controlled could otherwise increase the profit margin by reducing expenditures on services provided to tenants. This might lead, over time, to a potentially serious deterioration in the quality of rental housing stock. (1978, p. 16)

An exception to the cost pass-through principle was made in the case of financial loss. It was recognized that it would be both unfair and undesirable to lock a landlord into a loss situation with no mechanism for relief. As emphasized by the Green Paper: "failure to provide such relief would lead to rapid deterioration and perhaps even abandonment of existing rental stock" (1978, p. 16).

In 1976, amendments to the Residential Premises Rent Review Act were passed by the legislature on January 16, 1976 to provide greater security to tenants through the application of a 12-month minimum period for the duration of an Order of a Rent Review Officer or the Residential Premises Rent Review Board. As well, amendments were passed which extended various time limits in the Act for applications by landlords or tenants for rent review, for rebate of rent, and for advising parties of the date and place of hearings. According to Michael Cassidy:

> The need to extend deadlines for rent appeals, related to the early parts of 1976, became inevitable, given the Ministry's delays in establishing the rent review administration. (Ontario Legislative Assembly, Hansard, 2nd Session, 30th Parliament, Jan. 16, 1976, p. 171)

In April 1976, Mr. Handleman introduced further amendments to the legislation. The Report on the Ontario Rent Review Program (1976) indicated that:

> These amendments were designed to provide additional protection to tenants from too-frequent rent increases, as well as to direct the Program's resources to the sectors of the rental market where regulation was most needed. Certain types of rental premises of a non-profit or government-owned nature were exempted from the legislation.

The rent review legislation was to expire on July 31, 1977, however, on April 29, 1977, amendments to the Act extended this expiry date to December 31, 1978. At the same time there were other significant amendments made, including provisions that only one rent increase can be charged for any unit per 12-month period; that landlords are required to provide tenants with written reasons for a rent increase; that the guideline limit for rent increases implemented without review is tied directly to the Federal Anti-Inflation Board guidelines for wage increases; and that conviction for offences under the Act can result in a fine of up to $25,000 for corporations and up to $2000 for individuals. These penalty provisions are to remain in force beyond the December 31, 1978 expiry date.

Amendments to the Residential Premises Rent Review Board also became effective on April 29, 1977. The primary change that affected the Board's operations was the introduction of Section 13(7) which permitted the Board to reconsider a decision within a short time period after issuance of its order. Previously, there was no recourse for correction if it was determined that an error had occurred. Also, parties were allowed to request permission to appeal to the Board if they were not present at the initial hearing before the Program. Previously, only parties that had attended the first hearing could use the appeal process. The time limit for making an appeal was extended from 15 days to 21 days and the time of giving notice of appeal to the other parties was reduced from 30 days to 7 days. The reduction in time was complementary to the relief given to tenants from serving all parties together at the original hearing.

In October, 1977, the Anti-Inflation Board announced a reduction of its guideline for wages increased to 6 per cent. In keeping with the intent of April 29, 1977 amendments to rent review legislation, the Ontario government decreased the guideline for rent increases without review from 8 per cent to 6 per cent, effective October 27, 1977. In the Ontario legislature, Mr. Grossman stated that the reduction was due to the concern of the Ontario government with the protection it was giving tenants for the remainder of the rent review program (see Ontario Legislative Assembly, Hansard, 1st Session, 31st Parliament, October 27, 1977).

In the legislature, on June 23, 1978, the repeal of the Act was postponed to February 28, 1979. On June 16, 1978, Larry Grossman (Minister of Consumer and Commercial Relations) announced that the government would introduce legislation in the fall to incorporate:

- continuation of an improved rent review program until December 31, 1980;
- the guideline for rent increases to remain at 6 per cent until December 31, 1979;
- a tribunal to handle all residential landlord and tenant matters;
- the new scheme to permit calculations other than simple cost pass-through, when computing rent, including reference to comparative rents and the special conditions of landlords who are suffering real losses.

On September 30, 1978, Bill 163, An Act to reform the Law respecting Residential Tenancies, was introduced for first reading which:

- provides that where a tenant abandons a rental unit the landlord shall endeavour to rerent as soon as practicable and at a reasonable rent;
- creates a body, the Residential Tenancy Commission;
- codifies under one piece of legislation all rights and responsibilities of both landlords and tenants to give both groups for the first time a comprehensive understanding of their rights and the ability to exercise them;
- simplifies and improves the law relating to rent review;
- holds rent increases at the current 6 per cent guideline at least until the end of 1979;
- provides for whole building review (one rent review per building per year when a landlord wants to increase rent by more than 6 per cent);
- provides for hardship increases.

Mr. Drea, on introducing the bill, stated that:

> The prime object of this bill is to create a balance in the rights and responsibilities of landlords and tenants. To do this the bill sets out plainly what both parties may expect and what they must offer in return in language that the average tenant and average landlord can fully understand. This bill takes the residential aspects of the Landlord and Tenant Act and combines it together with revised rent review legislation into a clear, concise statute. (Ontario Legislative Assembly, Hansard, 2nd Session, 31st Parliament, September 30, 1978, p. 4313)

The establishment of a tribunal (the Residential Tenancy Commission) was a basic factor of the entire program. A hope existed that the tribunal would accomplish an improvement in landlord and tenant relations in Ontario by providing quick and easy mediation, arbitration and adjudication of all landlord and tenant matters. There was a belief that Bill 163 would rectify the deficiencies of the existing Landlord and Tenant Act dealing with particular situations. Mr. Drea asserted that:

> The bill will rectify these deficiencies by establishing, in simple language, rights, responsibilities and remedies -- quick remedies. It deals with the right to security of tenure, the right to evict, the right to compensation, the right to privacy, the right of access; but it does so in a balanced way. (Ontario Legislative Assembly, Hansard, 2nd Session, 31st Parliament, September 30, 1978, p. 4314)

The bill provided for a standard-form lease to which all written tenancy agreements must conform. Included in the form is a checklist, which the tenant must receive from a landlord, spelling out the contents and condition of the apartment and any house rules.

The bill extended the 6 per cent guideline. To streamline the system and make the rent review process more comprehensive, the bill provided for whole building review, i.e. one rent review per building per year when a landlord wants to increase rent by more than 6 per cent. This was an important procedural change. Previously, due to operational reasons, if a landlord of a multi-unit structure applied for rent increases for one unit at a time, he would involve both himself and the Commission in a repetition of evidence and unnecessary amount of time.

For the first time, the legislation made provisions to relieve landlords from hardships by permitting rent increases required to bring the gross revenue of a residential complex up to 2 per cent above cost. Prior to this amendment, the only rate of return consideration (under the current legislation) stemmed from the consideration of financial loss which permitted rent increases that tended to bring the landlord to a break-even position. Other than this, the cost pass-through principle of rent review, in general, permitted the same maximum amount of return to be potentially earned as was earned before controls was imposed. Accordingly, some landlords were locked into situations of little or no return, with no way of escape. The new bill made some provisions to permit landlords to work their way to a positive rate of return.

On August 17, 1979, the Lieutenant Governor proclaimed those sections of the Residential Tenancies Act necessary to establish the Residential Tenancy Commission and to provide for the continuation of the rent review program. The remaining sections of the Act, i.e. those dealing with the powers of the Commission to issue eviction orders or to require landlords and tenants to comply with their obligations under the Act, were referred to the Ontario Court of Appeal and the Supreme Court of Canada, for a ruling of their constitutional validity. On May 28, 1981, in an unanimous decision, the Supreme Court of Canada ruled that the 36 sections in dispute did not fall within provincial jurisdiction as set out in the BNA Act. Due to the Supreme Court decision, the Residential Tenancy Commission cannot perform the functions it was intended to perform in the area of landlord-tenant disputes. The Commission continues to operate under the proclaimed sections of the Act, hearing applications from landlords and tenants on rent increases and providing advisory services on residential tenancy matters.

Under Bill 163, several specific sanctions of the 1975 Act were omitted. The Thom Report suggests that:

> It appears to have been the legislature's intention that under the 1979 Act the Commission would not be responsible for enforcing the Act. (Volume 1, 1984, p. 39)

However, a change in policy regarding enforcement is that the 1979 Act provides for a sanction that was not in the 1975 Act, namely, the tenant's right to apply for an order requiring repayment of excess rent increases. These important differences between the two Acts suggest that the enforcement of the 1979 Act is the responsibility of tenants.

In December 1982, The Residential Complexes Financing Costs Restraint Act (called Bill 198), was enacted in response to the crisis resulting from the purchase and resale of some 11,000 units in the Toronto area. However, the Thom Report (Volume 1, 1984) notes that other cases as well as the Greymac-Kilderkin transactions may have given rise to the 1982 Act. The Report states:

> There seemed to be a common belief that there had been an increase in recent years, in the number of sales of residential complexes at what were believed to be excessive prices, with unfortunate consequences for tenants. (Volume 1, 1984, p. 122).

The Residential Complexes Financing Costs Restraint Act, 1982 contained a number of new legislative and policy initiatives to control rent increases attributable to financing costs requested by landlords upon the acquisition of rental property. One area of concern was the potential impact on rents that may arise out of the cost pass-through of the profits taken out of these properties. Bill 198 was introduced to ensure that there would not be an inequitable pass-through of these projects. (The Bill is intended to cover the present situation until a more detailed and thoughtful solution could be put in place.) With regard to Bill 198, Dr. Elgie, the Minister of Consumer and Commercial Relations, stated that there was:

> A belief that this bill would provide relief for tenants whose rents will be affected by cost increases arising out of a sale of the residential complex. Equally important, the bill should give a clear signal to those entrepreneurs who wish to speculate in residential tenancies that the tenants will not be made victims of their schemes. (Ontario Legislative Assembly, Hansard, 2nd Session, 32nd Parliament, December 2, 1982).

Bill 198 reversed and amended the Commission's policies on the apportionment of rent increases and the pass-through of financial loss. With regard to financial loss, the guideline of a five year break-even position was revised in November 1982 just before the 1982 Interim Act was passed. The 1982 Interim Act, Section 3 deals with the pass-through of financing loss as follows: the bill limits to a maximum of 5 per cent that portion of a rent increase attributable to increased financing costs claimed by a landlord as a result of his purchase of a residential complex. The intended effect of Section 3 was to reduce the rate at which financial losses resulting from the purchase of a complex would be passed through into rent increases. It provided a method of protecting tenants against large rent increases resulting from large financial losses. The section does not, however, reduce the total amount of the financial loss, all of which will eventually be passed through.

A further measure of protection to tenants against the impact of the pass-through of financial loss resulting from the purchase of a residential complex was accorded by Section 4 of Bill 198. The operation of Subsection 131(3) of the 1979 Act is suspended whenever a part of the rent increase that is to be determined is attributable to increases in financing costs resulting from any purchase of a residential complex. Under Section 4 of Bill 198, consideration cannot be given to granting a hardship allowance until after the pass-through has been completed.

Section 5 of Bill 198 changed the method of apportioning among tenants the total rent increase allowed on a whole building review. Prior to this change, the method of apportioning rent increases among tenants was usually through equalization, whereby landlords would reduce the differences between rents. Equalization took the form of increasing the rent of units at the lower end of a rent bracket more than those at the upper end of the bracket. Some concern was expressed about the alleged inequities of equalization. As the Thom Report notes:

> Equalization often results in substantial increases for the units with the lowest rents, and thus has serious consequences for the security of tenure of tenants of those units. (Volume 1, 1984, p. 135)

The main concern was the undesirability that excessively large increases should be charged to particular units in one year. Action taken by the legislature to remedy what was considered to be a flaw in the operation of the rent review program was to enact Section 5 of the 1982 Interim Act. This was to deal only with the problem of excessive rent increases for some units. The operation of Subsection 131(4) of the 1979 Act is suspended: a) The Commission shall apportion the total rent increase determined under subsections 131(1) and (3) of the 1979 Act equally amongst the rental units in the residential complex, on a percentage basis; and b) the landlord may increase the rent charged for each rental unit in the residential complex by an amount not exceeding the amount set out in the Commission's order.

On November 15, 1984, Dr. Elgie introduced a bill to amend the 1982 Residential Complexes Financing

Costs Restraint Act. This amendment extended the act for another year, until December 31, 1985. The intent of the amendment is to extend the sunset provision while the government considers a recommendation in the Phase I report of the Thom Commission that the act be kept in force. As well, based on Recommendation 58 of the Thom Report (Volume 1, 1984), the government temporarily revoked the regulation (Regulation 900 of the Revised Regulations of Ontario, 1980) implementing the $750 exemption level as of October 30, 1984, pending the further review of this recommendation by the government.

On December 20, 1985 Bill 77, An Act to amend certain Acts respecting Residential Tenancies, 1985, received royal assent. This bill lowers, from 6 per cent to 4 per cent, effective August 1, 1985, the amount by which a landlord may increase the rent charged for a rental unit without application to the Residential Tenancy Commission. As a follow-up to Regulation 900, Section 3(2) repeals clause 120(b) and clause 134(e) of the Act to make it clear that rental units not otherwise exempt from rent review are, as of August 1, 1985, subject to rent review irrespective of the amount of rent charged. The amendment act also extends the operation of the Residential Complexes Financing Costs Restraint Act, 1982, for another year, that is, from December 31, 1985 to December 31, 1986.

This subsection concludes with a table outlining the legislative changes in rent regulation in Ontario, 1975-1984.

SUBSECTION 6.4 -- Guideline Changes in Rent Regulation in Ontario, 1975-1984

Residential Premises Rent Review Act, 1975	1976 Amendments	Passage of Residential Premises Rent Review Amendment Act, 1977 provided for the continuation of the Act, as well as other key amendments	June 23, 1978: Passage of Bill 124, The Residential Premises Rent Review Amendment Act, 1978, extended the current legislation to Feb. 28, 1979	An Act to Reform the law respecting Residential Tenancies, 1979	Residential Complexes Financing Costs Restraint Act, 1982 (1982 Interim Act or Bill 198)	1984 Amendments
1. The 1975 Act does not apply to residential premises, or rental units that was located in a building of which no part was occupied as rented residential premises or as a rental unit before January 1, 1976. Tenants living in limited dividend housing, in luxury housing, in Ontario Housing and people who live in rooms are covered. Residential premises include any dwelling unit that contains a bathroom and kitchen facilities or land used as a site for a mobile home.	Certain types of rental premises of a non-profit or government-owned nature were exempted from the legislation.			As in the case of the 1975 Act, the 1979 Act does not apply to residential premises, or rental units that are rented residential premises or as a rental unit before January 1, 1976. The intent is to exempt construction in and after 1976 from rent regulation. Boarding and rooming houses are specifically included in the definition of "rental unit". The Act also exempted other living accommodations not specifically referred to in the 1975 Act. The most significant exemption was for units with monthly rent of $750 or more under the 1979 Act.		Regulation 908 under the Residential Tenancies Act is revoked. That is, rental units, the monthly rental for which is $750 is no longer exempt from Part XI of the Act (Ont. Reg. 168/80,s.1)
2. Under the 1975 Act, a tenant could dispute any rent increase ordered by a rent review officer; there was no restriction on the matters that could be raised for consideration at the hearing.				A tenant still has the right to dispute an intended statutory increase but the matters that can be considered by the Commission in disposing of the application are limited and do not include a review of a landlord's cost. Hence, although the right to dispute a statutory rent increase remains in the 1979 Act, it is not of great significance. However, the tenant does have a right under the 1979 Act which he did not have under the 1975 Act to apply for an order directing repayment of excess rent, referred to in a marginal note as illegal rent, and for an order declaring the rent that may lawfully be charged for the unit occupied by him. The last offence of the 1975 Act, to knowingly furnish false information, was the only one carried into the 1979 Act.		

1975 Act	1976 Amendments	1977 Amendments	1978 Amendments	1979 Act	1982 Act	1984 Amendments
3. The 1975 Act specifically made it an offence for a landlord to charge more than the statutory increase, to charge a rent increase to take effect within less than a year after the last increase, to collect more than the maximum rent chargeable under an order of the rent review officer, to refuse to fill a multi-unit application for rent review so ordered, and knowingly to furnish false information. Under the 1975 Act, a breach of these requirements was an offence punishable by a fine.	Jan. 16, 1976: Amendments to the 1975 Act provided greater security to tenants through the application of a 12-month minimum period for the duration of an order of a rent review officer or the 1975 Act. April 1976: Further amendments were designed to provide additional protection to tenants from too-frequent rent increases by preventing multiple rent increases within a 1-year periods without justification.					
4. Section 6 of the 1975 Act provided that, a landlord seeking an increase in rent shall, with the notice of a rent increase, supply the tenant with a notice of justification.		Instead of a formal notice of justification, the landlord would be permitted to supply written reasons for the increase. A new provision prevents a tenant from raising the issue of insufficiency of notice after the rent review officer makes his order if the tenant did not raise the issue at the hearing.		The 1979 Act departs radically from the 1975 Act by taking away from tenants the right they had under the 1975 Act to require the landlord to justify an intended statutory increase.		
5. Until the rent review officer makes his decision, a rent increase to the 8% limit established by the Act may be collected by landlords.		In keeping with the intent of April 29, 1977 amendments to rent review legislation, the Ontario government decreased the guideline for rent increases without review from 8% to 6%, effective October 27, 1977.				
6. The Residential Premises Rent Review Board was constituted by virtue of Section 12 of the Residential Premises Rent Review Act. The Board was composed of 53 members, of whom 29 were designated (in the words of the Act) "representative of tenants" while the remaining 24 were undesignated. Only adjudicative powers were conferred on the Rent Review Officers or the Residential Premises Rent Review Board. No provision was made for appeal of the Board's decision to the Supreme Court on a question of law, and no provision enabling the Board to rehear an appeal.		In amendments effective April 29, 1977, the primary change that affects the Board's operations is the introduction of Section 13(7) which permits the Board to reconsider a decision within a short time period after issuance of its order. Previously, there was no recourse for correction if it was determined that an error had occurred.		On the administrative side, the 1979 Act made changes that went to the root of the regulatory process. It established a tribunal to take over the administration of the new Act, with quasi-judicial and broad discretionary powers. The Act discontinued the earlier practice of appointing members who were representative of tenants. The Commission was given the authority to generally advise and assist the public on all residential tenancy matters to ensure that landlords and tenants understand their respective rights and obligations.		
7. Section 3(1) sets out the powers of a rent review officer and provides that he must give a copy of his order together with written reasons to all parties who appeared at the hearing.		The provision as amended still requires the rent review officer to give a copy of his order to all parties who appeared at the hearing, but does not require him to supply copies of the reasons except to those parties who request a copy of the written reasons.				
8. Rent increases can be determined on a building basis rather than always on a unit basis.				An important procedural change made by the 1979 Act is the requirement for a whole building review.		

1975 Act	1976 Amendments	1977 Amendments	1978 Amendments	1979 Act	1982 Act	1984 Amendments
9. Section 9 of the Act provides that a discontinuance of services or privileges is deemed to be an increase in rent. Section 11 of the 1975 Act permits an application to the rent review officer for an order of reduction of rent where there has been such a discontinuance.		The 1977 amendments clarifies that where there is a discontinuance of services, this shall not be considered an increase of rent in any 12 month period. It would still be open to the tenant to apply for a rent reduction under Section 11 of the Act. A new provision, Section 9, requires a landlord to provide a rental history of premises to a rent review officer where he is so requested in writing.				
10. Section 13(2) of the Act states that a tenant when appealing to the Board, shall give notice of the appeal to all other parties who were entitled to appear at the original hearing. The time for giving notice of appeal was 30 days after the filing of the notice with the Board. The time for filing an appeal with the Board was 15 days.		Section 13(2) was changed so as to relieve a tenant when appealing to the Board, from giving notice of the appeal to all other parties who were entitled to appear at the original hearing and instead giving notice to the landlord only. The time for filing an appeal with the Board has been extended to 21 days from 15 days and the time of giving notice of appeal to the other parties has been reduced from 30 days to 7 days.				
11. Clause 7(2)(a) provided that a rent review officer would approve an increase sought by a landlord if he was satisfied that increased operating costs and capital expenditures justified the increase. Clause 7(2)(b) directed the rent review officer to consider whether increased rents sought by the landlord were necessary in order to prevent the landlord from suffering a financial loss in the operation of the building.				The 1979 Act specifically recognized financing costs as an item to be taken into consideration in determining justified rent increases.		
12. The practice of tenants subletting and charging "key money" or more than the lawful rent were specifically prohibited.				The practice of tenants subletting and charging "key money" or more than the lawful rent is not dealt with in the 1979 Act.		
13. A relief of hardship was not provided for.				An allowance to relieve hardship could be made. Subsection 131(3) was a new feature of rent review.	Section 4 of 1982 Interim Act: The operation of subsection 131(3) of 1979 Act is suspended whenever a part of the rent increase that is to be determined is attributable to increase in financing costs resulting from any purchase of a residential complex. Under Section 4, consideration cannot be given to granting a hardship allowance until after the pass through has been completed.	Bill 147 - An Act to Amend the Residential Complexes Financing Costs Restraint Act, 1982 extends the 1982 Interim Act to Dec. 31, 1985. The short title of this Act is the Residential Complexes Financing Costs Restraint Amendment Act, 1984.

1975 Act	1976 Amendments	1977 Amendments	1978 Amendments	1979 Act	1982 Act	1984 Amendments
14. The guidelines suggested that substantial costs (such as capital expenditures and increased financing payments resulting from a rent purchase) and losses be passed through over more than 1 year to avoid extremely high percentage increases.				In the 1979 Act, provisions regarding financial loss are in Section 131 and are of the most general nature: "to allow a rental increase which would be sufficient to bring a landlord to a 'break-even' position over a period of time up to five years." This guideline was revised in Nov. 1982 just before the 1982 Interim Act was passed.	1982 Interim Act (Section 3) deals with the pass-through of financial loss as follows: the bill limits to a maximum of 5% that portion of a rent increase attributable to increased financing costs claimed by a landlord as a result of his purchase of a residential complex.	
15. The 1975 Act did not provide for whole building review, hence, apportionment od the total rent among all rental units in the complex was not provided for.				In a whole building review, apportionment of rent increases was usually based on a rent schedule prepared by the landlord. A common practice was to apportion the increases among the units so that rents charged to similar units became more or less similar. That practice was referred to as equalization.	Section 5 of the 1982 Interim Act changed the method of apportioning among the tenants the total rent increase allowed on a whole building review. Operation of subsection 131(4) of 1979 Act was suspended. Instead, a) the Commission shall apportion the total rent increased determined under subsections 131(1) & (3) of 1979 Act equally amongst rental units in the residential complex, on a percentage basis; & b) the landlord may increase the rent charged for each rental unit in the residential complex by an amount not exceeding the amount set out in the Commissioner's order.	

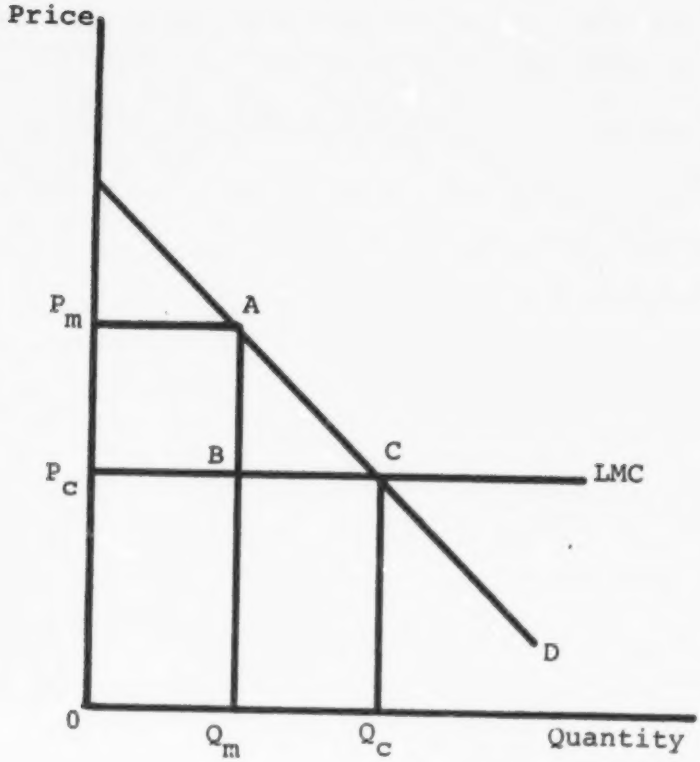
6.5 A Review of Rent Seeking Literature

Rent seeking as a specific term emerged in applied economic theory in the last decade. However, the concept has been with us for a long time. The theory of rent seeking purports to explain how and why economic agents, individually or in groups, actively invest effort, time, and other productive resources in varying attempts to shift the government's favour toward their own cause. The rent seeking theory of regulation implies that the social costs of the artificially contrived rents may not be limited to the traditional welfare loss triangle made known by Harberger (1954). If resources are used up in gaining a monopoly, or in nonprice forms of competition among established firms (e.g. lobbying), such rent seeking costs must be added to the standard welfare triangle loss associated with monopoly to obtain an estimate of the total social costs of regulation.

The purpose of this section is to examine the emerging theory of rent seeking society and to determine what relevance the theory may have to rent regulation.(14) The rent seeking literature has produced a blending of normative and positive elements of analysis. The normative side of the theory refers to the specification and estimation of the social costs of rent-seeking behaviour. The positive side of rent seeking attempts to explain the source and form of contrived rents in the political-economic system. We turn our attention first to normative rent seeking theory. A discussion of papers which offer positive-predictive analyses of the course of rent seeking activities will follow.

The welfare analysis of rent seeking concerns the issue of how costly such activities are to the economy. Analyses of the effect of 'rent creating' regulation have been provided by Tullock, Krueger, Posner, Cheung, and Becker.

Tullock (1967) has been regarded as the leading proponent of the rent seeking concept. Assessment into the nature of social costs imposed by rent seeking arose from Tullock's theoretical analysis. According to Tullock, the rent seeking concept originates from political activity like lobbying or pressuring. Interested individuals or groups will invest in lobbying until the marginal return on the last dollar spent is equal to its likely return producing the transfer. At the same time, other interests may also invest to maintain or redirect government activities to their benefit. Tullock argues that these expenditures are purely wasteful from the standpoint of society as a whole; they are not spent to create wealth, but in attempts to transfer or resist transfer of wealth. The conceptual diagram below (see Tollison, 1982) illustrates the argument more clearly. The welfare cost is the lost consumer surplus given by the triangle ABC.(15) A simple monopoly diagram is drawn ($Q_m = 1/2\ Q_c$). P_c, Q_c is the market equilibrium and P_m, Q_m is the monopoly equilibrium.



Tullock (1967) argues that, any resources spent to capture the monopoly benefits represented by the area enclosed by the rectangle P_mP_c AB are also a social cost of monopoly and that the conventional model of the welfare loss from monopoly in which monopoly profits are treated as lump-sum transfers from consumers to the monopolist, is incomplete if potential monopolists spend resources to capture the monopoly right. Tullock implies that through competitive rent seeking, the contrived, monopoly rents are easily dissipated.

Both Tullock (1967) and Posner (1975) argue that previous studies understate the social costs of monopoly by failing to recognize the costs(16) involved in attempts to gain and retain monopoly power. Estimates of welfare loss based on profits, net of rent seeking expenditures, underestimate the social cost of monopoly in two ways:

1. They understate monopoly rents and hence understate the distortions in output which the monopoly produces;
2. They fail to include these additional expenditures as part of the costs of monopoly.

The approach applied in empirical work with the competitive rent seeking model has been to estimate the area of the trapezoid $P_m P_c CA$ in the diagram rather than just the triangle ABC. Both Krueger (1974) and Posner (1975) have applied variations of such a model to derive estimates of rent seeking costs.

Krueger (1974) examines the allocative and distributive effects of foreign exchange regulations in India and Turkey. Krueger illustrates how the competition for import licenses may be carried to the point where all rents are bid away, with the economy operating at less than its potential (i.e., inside its transformation curve). Krueger concludes:

> To the extent that rent seeking is competitive, the welfare cost of imposed restrictions is equal to the welfare cost of the tariff equivalent plus the additional cost of rent seeking activities. (1974, p. 299)

Posner (1975) argues that, if obtaining a monopoly is a competitive activity, resources will be drawn into that activity such that the monopoly gains are eliminated and only a normal rate of return is earned. The reason is that resources will be wasted in a socially useless competition for this rent. Under conditions of uncertainty, the winning competitor for a monopoly may earn monopoly profits, but the losers' expenditures will make up the remainder of expected rents. In short, rents may be dissipated by the very effort to secure them.

Both Krueger and Posner suggest that, in a strongly competitive situation with large numbers of people competing for a 'free right', all rent will be dissipated. However, the analysis by Cheung suggests that the dissipation of rent need not be total. Cheung argues that, in the case of rent regulation, the development of new contractual arrangements between landlords and tenants could take place to prevent the total dissipation of rent. This argument is elaborated below.

Cheung (1974) expanded the scope of the theory of non-exclusive rights(17) by showing that it applied to non-exclusive access to money income as well as to non-exclusive access to resources. Cheung suggested that when the right to receive income is not exclusively assigned, dissipation of the income will ensue. Cheung also modified the rent seeking theory by considering market responses to regulation which hold prices below marginal costs. In such situations, not all rent will be dissipated because the people involved will try to contract with one another in order to prevent the total loss of unassigned income. Cheung derived two propositions for his analysis. Proposition one expresses that some form of capitalization (outright purchase or key money) will take precedence over total dissipation such as queuing. Proposition two expresses the notion that the market response will be a minimum cost response. With rent regulation, Cheung suggests that a number of market responses are possible. They include: tenants' competition to buy the tenement outright instead of leasing; the offering of 'key money' for the right of occupation; and the willingness to rent or buy furniture from the landlord at an exorbitant price or to be employed by the landlord at less than the market wage. The general proposition is that rent will be completely dissipated only in the area where the marginal cost of contracting exceeds the marginal reduction in waste.

Becker (1983) presents a theory of the political redistribution of income and of other public policies that builds on competition among pressure groups for political favours. The focus of Becker's analysis is the economic costs of political behaviour as reflected in 'lobby'. Lobbying costs are explicitly considered as an addition to the burden of taxpayers and as a subtraction from the benefits of subsidy recipients. In his model, two homogeneous pressure groups -- a group of taxpayers and a group of subsidy recipients -- compete for political favours. 'Influence functions' are developed, that relate subsidies and taxes to the pressures exerted by all groups and to other variables. The political budget equation between the total amount raised in taxes and the total amount available for subsidies implies that the sum of all influences is zero, i.e., the change in the influence of any group that affects its taxes and subsidies must affect the subsidies and taxes, and hence the influence of other groups.

The distortions in the use of resources induced by different taxes and subsidies, usually called deadweight costs, have a major effect on the competition for influence. In the political game model, an increase in the deadweight cost of a subsidy discourages relative pressure by the subsidized group because a given revenue from taxes then yields a small subsidy. An increase in the deadweight cost of a tax encourages relative pressure by taxpayers because a given reduction in their taxes then has a smaller effect on the amount available as a subsidy.

Becker's analysis shows that political equilibrium depends on the efficiency of each group in producing pressure, the effect of additional pressure on their influence, the number of persons in different groups as well as the deadweight costs of taxes and subsidies.

A common thread throughout the normative rent seeking literature is that, because of the waste of resources used to compete for rents, the welfare cost of a distortion that creates rents may be far greater than what is customarily measured as deadweight loss.

Tollison views the cost to society of rent seeking behaviour in the following manner:

> If the process by which monopoly rents are contrived is subject to competition (e.g. lobbying), the analytical fiction of these rents as a pure transfer vanishes because resources spent in the pursuit of a transfer are wasted from society's point of view. These expenditures add nothing to social product (they are zero-sum at best), and their opportunity cost constitutes lost production to society. (1982, p. 576)

Hartle holds a different opinion:

> The transfers are far from nothings to those who receive them or to those who are unfortunate enough to have to pay them. (1983, p. 541)

Rent seeking theory generalizes in positive economic terms to the interest group theory of government and legislation. The basic and powerful insight of positive rent seeking literature rests in its series of propositions regarding the behaviour of self-interested individuals. In a regulatory environment, individuals can seek contrived artificial rents through regulation favourable to themselves. Rent seeking behaviour implies that, competing interest groups will allocate available investment funds on the basis of their relative expected returns.

Stigler (1971) presents the interest group theory in terms of costs and benefits to various groups that use the state to increase their wealth. Stigler argues that there are important losses accompanying the benefits. That is, significant costs would be involved, both in obtaining regulations and in administering them, which will have to be borne by the firms who benefit. These costs are analogous to the deadweight costs discussed in Becker's study. Like Krueger and Tollison, Stigler concludes that the benefits conferred to rent seekers fall short of the social costs imposed on the rest of the community.

McCormick and Tollison (1981) present a theory of legislative activity based on the principle that legislation is equivalent to wealth transfers and that a useful way to model legislative activity is to consider politicians as brokers of transfers. The two authors develop a model of the relationships among: interest group expenditures on the purchase of legislative influences as the means of increasing the income of members; the wealth of a community (it is assumed that higher income means a higher opportunity cost for political monitoring by voters and hence more interest group success); population size (it is assumed that with a large population, the influence of any one voter decreases and the costs of the transfers per capita are smaller); and the size of the legislature.

The interest group theory has attracted a good deal of attention but the subject is still relatively new. Posner (1974) argues that the underpinning of the interest group theory does not yield testable hypotheses, and that virtually any behaviour can be reconciled with the interest group view. He also asserts that the effects of regulation are often difficult to trace.

Rent seeking, in general, has been absorbed into regulation literature, however, as Browning suggests:

> One should not be misled into thinking that all special-interest legislation that redistributes in favour of some group results from a lobbying effort... Politicians may enact special-interest legislation to gain votes without any lobbying being involved. (1980, p. 286)

6.6 Summary

Rent seeking has contributed to the analysis of government intervention in general and regulation in particular. However, there exists the feeling that it would be a mistake to make the present theory of rent seeking the sole component of a general theory of regulation. One must be aware of the fact that regulation is a dynamic, evolving process so that the impacts of regulation will also be evolving and changing (Cairns, 1980, p. 75). Cairns adds strength to this fact with the following statement:

> ...to understand regulation in Canada, one must recognize that regulation has had goals other than the attainment of economic efficiency. Indeed, these broad non-economic, social, political goals have usually been paramount... We submit that a policy that was never intended to promote economic efficiency cannot be measured solely in terms of its effect on economic efficiency. (1980, p. 78)

Notes to Section 6

(1) Marcuse (1978) defines this view as 'the theory of the benevolent state'. See subsection 6.3 for details.

(2) Cairns (1980) does not define the public interest, or social welfare. However, he does suggest that Dales (1975) captures the meaning in the following statement:

> It is hard to know precisely what 'net welfare for society' might mean, but it somehow defines both the problem of, and the necessity of government (p. 485).

(3) Marcuse (1978) identifies this view as 'the malevolent interests theory'. See subsection 6.3 for details.

(4) An exhaustive analysis of positive theories of regulation can be found in Stanbury and Thain (1985).

(5) Marcuse (1978) bases his argument on the theory that, a reduction in rents reduces the wages that would need to be paid to the worker to maintain him or herself. Marcuse states that there is no evidence that in the United States (and little elsewhere) the struggle for rent regulation has been seen as a part of workers' struggle for higher effective wages, for a greater share in the profits of production.

(6) For an explanation of the impact of these characteristics on the economic position of landlords, refer to Marcuse (1978, 13-15).

(7) The Cragg Report for the Rentalsman in British Columbia makes both these points:

> ...rent control...may be beneficial at the present time in providing a more orderly market. The Allowable Rent Increase can be used to indicate in general terms what would be a reasonable figure. The justification procedure at least indicates to tenants that a further increase is not completely arbitrary. (British Columbia, Interdepartmental Study Team on Housing and Rents 1975, 12-13).

(8) After the Depression, foreclosures were the number one problem for many middle-income families who had succeeded in purchasing their own homes in the 1920s. A moratorium on foreclosures, followed by assistance in refinancing, was their preferred public program. Marcuse (1978) notes that the history of efforts to achieve rent regulation and

effective rent regulation of housing standards reflects the absence of middle-income pressures in the 1930s.

(9) A report, Understanding Tenant Organizations and Rent Control suggests two factors which fuelled the tenant movement in the late sixties: a shortage of rental units and the law which governed landlord-tenant relationships (National Association of Home Builders, Apartment Construction and Management 1971, 3).

(10) Marcuse (1978, 33) argues that, intuitively, the issues that seem to have had the potential to lead to major social change include civil rights, welfare rights, national autonomy, employment and peace. The issues that do not seem to have such potential include health, hunger, education, political rights and housing.

(11) "Because of the high capital cost of new housing, as well as its high operating costs, income inequalities will be blatantly exhibited in housing patterns. The demands of production and the demands of consumption conflict directly in the market for land, unlike the market for telephones, for instance. Production dominates and consumers must buy their way out of the resulting problems with such incomes as they may have". (Marcuse, 1978, 25)

(12) Marcuse suggests that the push to regulate rents below the fair return level, and to deal with hardship issues, moves from common interest to reciprocity. "Middle-income tenants do not suffer from hardship in the same sense as those of low income, and the ideological implications of hardship formulas will not appeal to those already doing well within the system" (1978, p. 26). However, Marcuse points out that within limits, effective coalitions can be and have been built around rent regulation.

(13) The 'Green Paper' refers to Policy Options For Continuing Tenant Protection by the Ontario Ministry of Consumer and Commercial Relations (1978).

(14) Hartle also considers the theory of rent seeking as it relates to residential rent regulation. See Hartle (1984, Section 4: 30-45).

(15) This partial equilibrium analysis was developed by Harberger (1954).

(16) Efforts to obtain tariff protection, patent protection, and other types of preferential government treatment, through campaign contributions, lobbying or bribery are part of the social costs of monopoly as defined by Tullock (1967) and Posner (1974).

(17) This theory suggests that, if rights are non-exclusive, rent seeking activities will be engaged in, in order to capture the benefits of the rights. The main conclusion that emerges from the theory of non-exclusive rights is that 'rent will be dissipated' by wasteful activities such as excessive transactions costs.

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Research Studies

The following is a list of papers commissioned by the Inquiry.

No.

1 Slack, Enid and Sherry Glied. Rent Registry Alternatives.

2 Reid, Frank. Collective Bargaining for Tenants.

3 Jaffary, Karl D. Problems in the Regulation of Rents for Roomers and Boarders.

4 MacDonald, Daniel V. Constitutional Reference Re: The Residential Tenancies Act.

5 Fallis, George. Possible Rationales for Rent Regulation.

6 Hulchanski, J. David. Market Imperfections and the Role of Rent Regulations in the Residential Rental Market.

7 Sharp, Campbell, Pannell Kerr Forster Campbell Sharp. Survey of Financial Performance of Landlords.

8 Marks, Denton. Housing Affordability and Rent Regulation.

9 Steele, Marion and John Miron. Rent Regulation, Housing Affordability Problems, and Market Imperfections.

10 Clayton Research Associates Limited. Rent Regulation and Rental Market Problems.

11 Makuch, Stanley M. and Arnold Weinrib. Security of Tenure.

12 Hartle, D.G. The Political Economy of Residential Rent Control in Ontario.

13 Slack, Enid and David P. Amborski. The Distributive Impact of Rent Regulation.

14 Knetsch, Jack L., Daniel Kahneman and Patricia McNeill. Residential Tenancies: Losses, Fairness and Regulations.

15 Stanbury, W.T. Normative Bases of Rent Regulation.

16 Stanbury, W.T. Normative Bases of Government Action.

17 Stanbury, W.T. and P. Thain. The Origins of Rent Regulation in Ontario.

18 Stanbury, W.T. and I.B. Vertinsky. Rent Regulation: Design Characteristics and Effects.

19 Chant, John. Overview of Alternative Rental Housing Policies.

20 Foot, David K. Housing in Ontario: A Demographic Perspective.

21 Quirin, G. David. Regulatory Systems and their Applicability to Rent Controls.

22 Mascall, M. and Associates. Report of the Ontario Rental Housing Market.

23 Environics Research Group Limited. Financing Residential Rental Accommodation: A Survey.

24 Ekos Research Associates Inc. A Study of Landlords and Rent Regulation.

25 des Rosiers, Francois. A Rent Control System in Quebec.

26 Slack, Enid. The Costs of Rent Review in Ontario.

27 Muller, Andrew. Workable Rent Regulation: A Synthesis.

The following is a list of papers prepared by the research staff of the Inquiry.

28 Adams, Eric B., Pearl Ing and John Pringle. A Review of the Literature Relevant to Rent Regulation.

29 Adams, Eric B., Pearl Ing, Janet Ortved and Mary Jane Park. Government Intervention in Housing Markets: An Overview.

30 Pringle, John. Ontario's Residential Tenancies: A Statistical Profile.